Highlights:

China kicked off the first week of New Year with massive roll out of regulations. The most eye-catching is the regulation 302 which was unveiled by four top financial watchdogs jointly, to standardize China's onshore bond transaction as part of financial de-leverage campaign to prevent from the outbreak of systemic risk. The new regulation 302 mainly targets two areas. First, it is designed to cover the loophole of under the table entrusted bond holding business, which becomes the channel for bond holders to skirt the capital requirement. Second, the new regulation also set the repo cap for all financial institutions. The new regulation also put China's bond market under the renewed pressure despite loose liquidity.

China's banking regulator also unveiled three other regulations last Friday targeting entrusted loan, commercial bank's risk exposure and commercial bank's major shareholder. All the changes sent one clear message that "back to fundamental and transparency" will be the key regulatory guidance for China's commercial banks to contain financial risk. All those measures will eventually lead to de-leverage. For the drafted rules to limit commercial bank's risk exposure, it will force banks to reduce their reliance on interbank business, which will eventually help curb leverage. Meanwhile, by limiting exposure to single counterparty, it will also encourage banks to step up their support to small and medium sized businesses to support the real economy via more efficient financial resource allocation.

On liquidity front, the PBoC has suspended the daily open market operation for 10 consecutive trading days as liquidity remained flush. China will continue to use tighter regulatory measures as long term solution to contain financial risk while remaining flexible on liquidity offering to strike the balance between de-leverage and market stability. On currency, the USDCNY ended the week below 6.50. RMB's appreciation in the first week was mainly driven by dollar weakness and there is no strong evidence of self-engineered appreciation pressure as the RMB index was changed in the first week. Although there is media talk in the onshore market about defending 6.50, we think the recent appreciation pace does not create trouble for policy makers. China's policy makers should have higher tolerance for the USDCNY to test 6.45 should dollar weaken further.

In Hong Kong, one-month HIBOR subsided as year-end effect abated. With HIBOR continuing to lag behind LIBOR, HKD faced renewed downward pressure. We expect one-month HIBOR to drop further. Still, it may find support at 0.8% before rebounding gradually due to several reasons. First, aggregate balance has reduced to HK$179.77 billion as at 4 January 2018, the lowest level since mid-2014. Second, the effect of Lunar New year may push up HIBOR. Third, banks may hoard cash in preparation for capital outflows on global monetary tightening. Fourth, strong local loan demand and funding needs of Mainland companies have pushed HKD loan-to-deposit ratio up to its highest level since 2015 at 81%. This suggests that funding needs across the banking system may remain strong. Finally, potential large IPOs would lock up money. All in all, we expect one-month HIBOR will increase gradually after a brief correction and reach 1.4% by end of 2018. In Macau, gaming revenue growth moderated to 14.6% yoy in December 2017 amid high base effect. Still, 2017's growth reached its strongest level since 2011 at 19.1%. Moving forward, policy risk and liquidity risk could hit the VIP segment. Adding on a high base effect, gaming revenue growth is likely to decelerate to 10% - 15% in 2018 despite an expected expansion of mass-market segment.

Key Events and Market Talk

Facts	OCBC Opinions
▪ China's four top financial watchdogs jointly unveiled the regulation 302 to standardize China's onshore bond transaction as part of financial de-leverage campaign to prevent from the outbreak of systemic risk. The new regulation will apply to bond related transactions including cash bond trading, bond repo, bond forward and bond lending and borrowing. ▪ The new regulation 302 will grant market one-year grace period.	▪ The new regulation 302 mainly targets two areas. First, it is designed to cover the loophole of under the table entrusted bond holding business, which becomes the channel for bond holders to skirt the capital requirement as well as weaken the risk management. The entrusted bond holding has effectively become one of the channels for financial leverage. The ban of those under the table cross bond holdings will help regulators keep leverage in check. ▪ Second, the new regulation also set the repo cap for all financial institutions. Total outstanding of bond repo should not exceed 80% of net assets for deposit taking financial institutions while this cap will be 120% for securities firm, funding houses and futures brokerages. The cap for insurance companies will be measured by total assets with the outstanding repo volume as percentage of total assets should not exceed 20%. Bond repo has been the main channel for China's financial institutions to leverage up to enhance their

	returns. The introduction of black and white hard ceiling will serve the regulatory purpose of de-leverage. ▪ Meanwhile, China's security regulator CSRC also unveiled the regulation 89 as supplementary regulation to regulation 302. The regulation 89 will give risk management team more power to check the price deviation. The bond trader is required to report should transacted price deviate 1% from the benchmark price. In addition, total annual compensation which is above CNY1 million will be subject to deferral scheme for bond traders to curb the moral hazard problems.
▪ China's banking regulator CBRC tightened its supervision on entrusted loan.	▪ The new rule asks the banks to strengthen the monitor of source of funds as well as use of funds. For example, the loan proceeds cannot be used for investment in bonds, derivatives, asset management product or equities. In addition, responsibility and rights of all relevant parties of entrusted loan will also be defined in details. ▪ As part of China's off-balance sheet financing, entrusted loan has played an important role in financing China's growth with total outstanding reached CNY13.9 trillion as of November 2017. However, the growth of entrusted loan has decelerated in 2017 due to China's de-leverage campaign. Total outstanding of entrusted loan as percentage of aggregate social financing fell to 8% as of November 2017 from 8.46% in 2016. As such, we think the impact of recent tightening may not have significant impact on China's credit growth.
▪ China's banking regulator unveiled the drafted rules to limit commercial bank's risk exposure. ▪ The new rule will be effective from 1 July 2018 and commercial banks are expected to comply by end of 2018. However it also granted three-year grace period to commercial banks to meet their risk exposure requirement to interbank counterparties.	▪ The large scale risk exposure was defined as risk exposure to single counterparty or a group of connected customers, which is more than 2.5% of bank's tier-1 capital. ▪ For non-interbank clients, the outstanding of loan book to single counterparty cannot exceed 10% of bank's tier-1 capital. The risk exposure to single counterparty and a group of connected counterparties will be capped at 15% and 20% of bank's tier-1 capital respectively. ▪ For interbank clients, the risk exposure to both single counterparty or group connected counterparties are not allowed to exceed 25% of bank's tier-1 capital. ▪ The measurement of risk exposure will include both banking book and trading book. However, the risk exposure to Chinese government, PBoC, IMF, BIS and other country's central government and central bank with minimum AA- credit rating will not be counted. In addition, bank's exposure to provincial local government and policy bank will also be exempted. ▪ Meanwhile, the drafted rule also asks bank's board to take ultimate responsibility for large scale risk exposure. ▪ The drafted will force banks to reduce their reliance on interbank business, which will eventually help curb leverage. Meanwhile, by limiting exposure to single counterparty, it will also encourage banks to step up their support to small and medium sized businesses to support the real economy via more efficient financial resource allocation.
▪ China's banking regulator CBRC published interim rules to tighten its scrutiny over commercial bank's shareholding. ▪ The new measures will apply to all onshore commercial banks. However, for foreign banks, the change of shareholding structure will be subject to other rule, which will be published in a separate	▪ Shareholders who own more than 5% of total shares or have influential power on business management will be considered as major shareholders. The major shareholders are not allowed to transfer their shareholding within the first five years of ownership. Meanwhile, the major shareholders should commit to shore up the capital of commercial banks if needed in written agreement.

time.	▪ Meanwhile, a single asset management product is not allowed to hold more than 5% of single commercial bank's share. This may discourage insurance companies which previously increase their stake in commercial banks via investment products aggressively.
▪ On liquidity front, the PBoC has suspended the daily open market operation for 10 consecutive trading days as liquidity remained flush.	▪ China has been generous in terms of short term liquidity offering to meet the funding demand ahead of the lunar New Year. China will continue to use tighter regulatory measures as long term solution to contain financial risk while remaining flexible on liquidity offering to strike the balance between de-leverage and market stability.
▪ One-month HIBOR subsided as year-end effect abated.	▪ With HIBOR continuing to lag behind LIBOR, HKD faced renewed downward pressure. We expect one-month HIBOR to drop further. Still, it may find support at 0.8% before rebounding gradually due to several reasons. First, after two rounds of additional exchange fund bill sales, aggregate balance has reduced to HK$179.79 billion as at 2 January 2018, the lowest level since mid-2014. Second, the effect of Lunar New year may push up HIBOR. Third, banks may hoard cash in preparation for capital outflows on global monetary tightening. Fourth, strong local loan demand and funding needs of Mainland companies have pushed HKD loan-to-deposit ratio up to its highest level since 2015 at 81%. This suggests that funding needs across the banking system may remain strong. Finally, potential large IPOs would lock up money. All in all, we expect one-month HIBOR will increase gradually after a brief correction and reach 1.4% by end of 2018.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's FX reserve rose for the 11th month in December by US$20.7 billion to US$3.14 trillion.	▪ The rebound of FX reserve was mainly the result of valuation effect as the weakness of dollar extended in December.
▪ HK: The growth of secondary housing prices index (+13.1% yoy) accelerated for the first time since June 2017 in November 2017. However, November's approved mortgage loans dropped for the third consecutive month by 7.1% yoy. Though total housing transactions rebounded by 50.3% yoy in December 2017 after five consecutive months of decline, the average transaction volume (4913 deals) during the second half of 2017 is much lower than that (5795 deals) over the same period in 2016.	▪ Taken all together, it reveals that the acceleration of secondary housing prices growth could have been transitory. As a piece of residential land was sold at record high price in November and property developers raised selling prices, this exerted spill-over effect to the secondary housing market. Wealth effect from stock market and housing market also encouraged investors to enter the overheated housing market. Given sluggish demand for residential mortgages, it is possible that a small group of affluent investors who do not rely on bank loans have been the main driver of the recent growth in housing prices and housing transactions. ▪ Moving into 2018, local affluent investors and those from Mainland China may continue to support the housing market. However, should global monetary tightening lead to capital outflows from emerging markets, HK banks may have to lift prime rate and in turn deter those prospective buyers who rely on mortgage loans. On the other hand, any correction in HK stock market resulted from capital outflows may reduce wealth effect. This will also damp some investment demand in housing market. Therefore, we expect housing transactions to remain muted in the 2018. Secondary home prices index is expected to grow by 0%-3% in 2018.

▪ HK's retail sales grew at the fastest pace since February 2015 by 7.5% yoy in November 2017.	▪ On the one hand, China's resilient economic growth has supported its outbound tourism. The number of tourists from Mainland China (accounting for around 75% of total visitor arrivals) grew for the third consecutive month by 8.6% yoy (highest since March 2017). This helps to sustain the growth in sales of luxurious goods (+7.9% yoy) and sales of clothing, footwear and allied products (+3.8% yoy). On the other hand, driven by benign real wage growth and wealth effect from bullish stock market, strong local demand has also supported the retail sector. Sales of food, alcoholic drinks and tobacco and those of goods in supermarkets grew by 3.8% yoy and 1.9% yoy respectively. More notably, the launch of new iPhone device led the sales of consumer durable goods to climb at its fastest pace since June 2015 by 15% yoy. ▪ Retail sales are expected to grow by about 2% in 2017 and advance further by 5%-8% in 2018 amid low base effect, solid labor market and further improvement in tourism activities. If this is the case, the rent and price of private commercial retail units are likely to rebound gradually. However, given the prevalence of overseas online shopping, upside of retail sector may be limited in the longer term. Also, the slash of import tariff on 187 consumer goods by China's Ministry of Finance will have some negative effect on Hong Kong's retail sector.
▪ Macau's gross gaming revenue grew at a slower pace by 14.6% yoy to MOP 22.7 billion in December 2017. Though December's data misses market expectations, 2017's gaming revenue growth still reached its strongest level since 2011 at 19.1% yoy.	▪ Looking ahead, Macau regulators are reported to plan to tighten standards for licensing junket operators in January 2018. Besides, global monetary tightening may translate into higher funding costs for junket operators and hinder their provision of credit extensions for high rollers. In short, as VIP segment may face policy risk and liquidity risk, we expect its contribution to gaming growth will reduce somewhat in 2018. ▪ In contrast, mass-market segment, which will be supported by Asia's economic growth, may make more contribution to gaming growth in the longer term. Nevertheless, gaming growth led by mass-market segment may be weaker than that driven by high rollers. Adding on a high base effect, we expect gaming revenue growth will decelerate to 10%-15% yoy in 2018.

RMB	
Facts	**OCBC Opinions**
▪ RMB strengthened against the dollar in the first week of the New Year riding on the weak broad dollar story with the USDCNY ended the week below 6.50.	▪ RMB's appreciation in the first week was mainly driven by dollar weakness and there is no strong evidence of self-engineered appreciation pressure as the RMB index was barely changed in the first week. The index closed at 94.90 last Friday, up slightly from 94.85 in 2017. We expect RMB to remain a dollar play in the near term. ▪ Although there is media talk in the onshore market about defending 6.50, we think the recent appreciation pace does not create trouble for policy makers. China's policy makers should have higher tolerance for the USDCNY to test 6.45 should dollar weaken further.

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