Highlights

US President Trump has played his trade card pretty well and most US's allies were busy with asking for exemption over the weekend. Nevertheless, it is not in China's gene to ask for exemption from the trade tariff. Instead, China will continue its talk with the US. The trade tension between China and US is expected to remain the focus in the coming weeks though the de-escalation of North Korea nuclear crisis is likely to add positive sentiment to the region after both leaders from North Korea and US agreed to talk.

On China's financial reform, the outgoing Governor Zhou Xiaochuan said it is the time for China to be braver to open its financial market after entering a new era. Zhou also said containing financial risk is part of China's financial reform. The declining financial risk will open the room for further reform and openness. On RMB Internationalization, Zhou Xiaochuan said most policy measures have been studied and China has done its own part and future development will depend on end user's needs for RMB settlement in trade and investment. China may continue to connect China's capital market to global capital to facilitate gradual pace of RMB Internationalization.

The February data so far supported the synchronised global recovery story. The strong import of electronic integrated circuit implies that China's export is likely to remain strong in the coming months. China's credit expansion was in line with market expectation in February. The strong demand for medium-term lending was partially attributable to the return of funding demand from off-balance sheet to on-balance sheet as part of China's de-leverage campaign. This also justifies China banking regulator's decision to lower the loan provision coverage ratio to alleviate banks' pressure. In addition, the surge of CPI to more than four year high is due to seasonal effect. Nevertheless, the low base effect may still keep CPI to stay above 2.5% in the coming months. However, we don't expect the current CPI to be a concern for monetary policy to move even tighter.

On currency, RMB is expected to continue its consolidation mode this week during the NPC as we don't expect any major talking points about currency from the meeting. We think it is the right direction for China to further loosen its grip on outflows. In the longer run, China should be careful about the potential impact of dollar weakness as history shows that the US initiated trade tension always ended with weaker dollar.

In **Hong Kong**, USD/HKD continued to refresh its highest level in 33 years due to increasing speculation on a wider yield differential before March FOMC. However, given little sign of capital outflows, the currency pair may not touch 7.85 at this juncture. On the one hand, as USD/HKD gets closer to 7.85, market increasingly expects that interest rate gap will narrow soon. Knowing that loss from HKD appreciation and a narrower yield differential is highly likely, speculators may rather remain cautious. On the other hand, after March FOMC, LIBOR may stabilize. In comparison, high HKD loan-to-deposit ratio, increasing large IPOs following the revamp of IPO rules in 2Q 2018, and banks' preparation for capital outflow risks may contain the downside of HIBOR. As such, yield differential is likely to refrain from widening further in the near term and in turn sideline some carry trades. All in all, with carry trade being the only unfavourable factor to the HKD at this juncture, HKD may not weaken so rapidly towards the weak end. In the medium term, however, further and faster tightening of global liquidity and US tax reform could lead to capital flight from HK and push USD/HKD to 7.85. Still we believe that the sizeable foreign currency reserve will help the HKMA to well maintain the Linked Exchange Rate System. However, the impact on the economy is inevitable. Sharp increase in local interest rates together with increasing supply will highly likely slow down housing growth.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China set its growth target at around 6.5% for 2018. However, it lowers its fiscal deficit target to 2.6% from previously 3%, first budget deficit target cut since 2012. ▪ In addition, China also scraps the hard target of M2 and aggregate social financing growth for 2018.	▪ It is a fairly balanced government report. The fine-tune of growth target via removal of "higher if possible" shows a higher tolerance for slower growth as 6.5% growth is still sufficient for China to generate enough jobs. ▪ The reduction of fiscal deficit target by 0.4% does not mean the change of proactive fiscal policy tone as total fiscal deficit remains unchanged. The reduction of fiscal deficit as % of GDP was mainly the result of growth of China's nominal GDP size. ▪ The correlation between M2 growth and economic growth is weakenining due to change of funding structure. The impact of traditional loan on M2 growth has been falling. As mentioned by PBoC deputy Governor Yi Gang, new M2 growth is less important and China will focus on optimising structure of existing financing

	this year.
▪ China's banking regulator allowed banks to set aside lower loan provision coverage ratio to minimum 120% from previously 150% on a case by case basis.	▪ The lower coverage ratio will help unlock more profit for banking sector. However, we doubt the change was designed to boost credit growth to support economic growth. Instead, as part of de-leverage campaign, the loan demand has returned from the off-balance sheet sector to on-balance sheet, as such, bank lending has again played a more important role. The reduction of loan provision coverage ratio will help alleviate the pressure for banks.
▪ Liu He said during the NPC meeting that both China and US expressed no desire for trade war during his trip to the US last week. ▪ In addition, China's Commerce Minister Zhong Shan said there is no winner in trade war and China's trade surplus with the US was overestimated by about 20%. The deficit could be reduced by 35% should US ease export controls on high-tech products.	▪ As mentioned by Liu He and Commerce Minister China is still in talk with US although there are no details given. Although most US allies have started to ask for exemption in the past few days with the success story of Australia, it is not probably in China's gene to ask for exemption. ▪ The trade tension between China and US will remain the focus in the coming weeks. We see low risks of full scale trade war and China may choose to recompense injuries with kindness as the soft approach to settle the dispute.
▪ China's central bank updated the latest plan for financial reform and development in its press conference during the NPC session.	▪ PBoC deputy Governor Yi Gang suggested market should look at China's real interest rate and said China's real interest rate remained stable in 2017 despite higher nominal interest rate as the result of financial de-leverage. ▪ In terms of financial reform, the outgoing Governor Zhou Xiaochuan said it is the time for China to be braver to open its financial market after entering a new era. ▪ On RMB Internationalization, Zhou Xiaochuan said most policy measures have been studied and China has done its own part and future development will depend on end user's needs for RMB settlement in trade and investment. China may continue to connect China's capital market to global capital to facilitate gradual pace of RMB Internationalization. ▪ On financial de-leverage, Zhou Xiaochuan said the fact that M2 growth is lower than nominal GDP growth shows that China's financial de-leverage is taking effect. As part of funding demand is shifting back to on-balance sheet, market should look at China's aggregate financing to gauge the leverage situation and he is confident that China has entered the phase of stabilized leverage ratio. ▪ Zhou Xiaochuan said containing financial risk is not the competitor to financial reform and it is part of China's financial reform. The declining financial risk will open the room for further reform and openness.
▪ USD/HKD continued to refresh its highest level in 33 years due to increasing speculation on a wider yield differential before March FOMC. The gap between one-month LIBOR and one-month HIBOR widened to the largest since 2008 at 105 bps on 8 Mar 2018.	▪ However, given little sign of capital outflows, the currency pair may not touch 7.85 at this juncture. On the one hand, if more investors short HKD, HKD will soon reach the weak end of the peg. And then HKMA's intervention will push up both HKD exchange rate and interest rate. Therefore, as USD/HKD gets closer to 7.85, market increasingly expects that interest rate gap will narrow soon (on 9 March, 12-month USD/HKD forward points jumped from -617 on 27 February to -365. One-year HKD Interest Rate Swap surged to its highest level since 2008 at 1.85%). Knowing that loss from HKD appreciation and a narrower yield differential is highly likely, speculators may rather remain cautious. ▪ On the other hand, after March FOMC, we believe that LIBOR will stabilize. In comparison, high HKD loan-to-deposit ratio, increasing large IPOs following the revamp of IPO rules in 2Q

	2018, and banks' preparation for capital outflow risks may contain the downside of HIBOR. As such, yield differential is likely to refrain from widening further in the near term and in turn sideline some carry trades. All in all, with carry trade being the only unfavourable factor to the HKD at this juncture, HKD may not weaken so rapidly towards the weak end. ▪ In the medium term, further and faster tightening of global liquidity and US tax reform could lead to capital flight from HK and push USD/HKD towards 7.85. Still we believe that the sizeable foreign currency reserve will help the HKMA to well maintain the Linked Exchange Rate System. According to the HKMA, official foreign currency reserve assets of Hong Kong amounted to USD443.5 billion, far outweighing the estimated USD130 billion inflows since Global Financial Crisis. However, the impact on the economy is inevitable. Either capital flight or HKMA's intervention will lead to a faster increase in HIBOR and prompt banks to lift the prime rate. Combined with increasing housing supply and potential correction in stock market, housing market growth is highly likely to slow down.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's FX reserve fell in February to US$3.134 trillion, first monthly decline since January 2017.	▪ Although the foreign currency sale flows by exporters ahead of Chinese New Year may add to the build-up of FX reserve, the decline of FX reserve was probably mainly attributable to valuation effect due to the rebound of broad dollar and global equity market sell-off triggered by higher US Treasury yields. China's currency regulator SAFE chief Pan Gongsheng confirmed the same view last Friday during PBoC's press conference. ▪ Looking ahead, as China's previous capital control measures have returned to neutral, we expect cross border flow to be balanced. The return of foreign currency demand may cap the accumulation of FX reserve.
▪ China's trade data surprised market on the upside despite Chinese New Year effect. Export in dollar term grew by 44.5% yoy while import in dollar term grew by 6.3%.	▪ By destination, exports to US, EU and Japan surged by 46.1%, 42.4% and 31.2%, a sign that China continued to benefit from the synchronized growth story. ▪ The deceleration of import was mainly the result of Chinese New Year effect. Imports of crude oil and iron ore by volume only increased by 1.5% and 0.9%. However, as a result of higher oil prices, imports of crude oil by value grew at a strong pace of 26.4%. ▪ Imports of electronic integrated circuit by value grew by 14.8% yoy in February. For the first two months, it grew at a strong pace of 36.5%. As imports of electronic integrated circuit tend to lead export by one month. This suggests that China is likely to benefit from the global recovery further in the coming months. ▪ Last but not least, China's trade surplus with the US increased to US$20.96 billion, highest February reading in record. This probably explains why Trump administration has escalated the trade tension between US and China.
▪ China's credit expansion was in line with market expectation in February. The new Yuan loan increased by CNY839.3 billion after a record expansion of CNY2.9 trillion in January. Aggregate social financing increased by CNY1.17 trillion. ▪ In addition, money supply M2 reaccelerated to	▪ Despite seasonal effect, the demand for medium term loan was above expectation in February. Total medium-term loan to household and corporate increased by CNY980.5 billion, exceeding new Yuan loan growth. This may remain supportive of real growth in the coming months. ▪ The strong demand for medium-term lending was partially

8.8% from 8.6% in January.	attributable to the return of funding demand from off-balance sheet to on-balance sheet as part of China's de-leverage campaign. The off-balance sheet entrusted loan fell for the second consecutive month by CNY75 billion in February. In addition, banker's acceptance also fell to CNY10 billion from CNY143.7 billon in January. ▪ As the rotation of funding demand back to on-balance sheet continues, we expect loan growth to remain strong in the coming months. This also justifies China banking regulator's decision to lower the loan provision coverage ratio to alleviate banks' pressure. ▪ Foreign currency deposits remained unchanged in February after surge of US$44.8 billion as market is probably reassessing the RMB outlook following the recent appreciation.
▪ China's inflation surprised the market on the upside probably due to seasonal effect. CPI jumped to 2.9% yoy, highest since November 2013. However, PPI decelerated further to 3.7% yoy.	▪ China's consumer price index rose by 1.2% month-on-month due to Chinese New Year effect as a result of higher food prices and service prices. We expect CPI to soften slightly in the coming months. However, as low base effect is expected to kick in, we expect the decline of CPI to be mild and CPI is expected to stay above 2.5% for the next two months. ▪ For PPI, we expect PPI to stay below 4% in March.
▪ HK secondary housing price index refreshed its record high for the 15th straight month and rose by 15.4% yoy in January 2018. Besides, housing transactions increased for the third consecutive month by 34% yoy to 5482 deals in February 2018.	▪ As the government loosened property control measures on upgraders, housing transactions are likely to rebound slightly in the coming months. In addition, one-month HIBOR has been under pressure given flush liquidity. This allows banks to reduce the spread on HIBOR-based mortgage plans (from one-month HIBOR + 1.3% to one-month HIBOR + 1.25%). Adding on banks' successive launch of fixed-rate mortgage plans, potential homebuyers might have been encouraged to enter the market. As a result, approved mortgage loans are expected to rebound in the near term after growing 34.8% yoy (+37.1% mom) and ending four consecutive months of negative growth in January 2018. However, with higher volatility of the stock market, wealth effect may reduce and weigh on investors' demand for property. Should global central banks tighten their monetary policy at a faster pace than expected, any capital flight from emerging market to developed market is likely to weigh on risk assets and trigger the start of prime rate hike. If this is the case, housing demand may take a hit. Furthermore, the government is planning to add more new supply of private and public housing than original estimate. This may also help to calm the overheated housing market. All in all, we expect housing price growth to moderate this year.
▪ HK's retail sales rose by 4.1% yoy in January 2018, missing expectations. Sales of food dropped by 5.4% yoy, the largest decline since February 2017 probably due to calendar effect. Also, sales of goods in supermarkets tumbled 13.3% yoy.	▪ In terms of other major retail outlets, sales of clothing and footwear increased by 0.9% yoy. Sales of consumer durable goods and those of luxurious goods jumped 20.5% yoy and 10.4% yoy respectively. This reinforces that improved tourism activities still supported the retail sector. In addition, a weaker HKD and sustained growth in Asia will bold well for tourist spending. On the other hand, a tight labor market (local unemployment rate reduced to a two-decade low) and wealth effect from stock market and housing market underpinned domestic consumer sentiment. Therefore, we hold onto our view that the retail sector will perform better this year than last year. This may add upside risks to retail shop rents (+4.1% yoy in Dec 2017) and prices (+7.5% yoy in Dec 2017).

RMB	
Facts	**OCBC Opinions**
▪ RMB remained relatively stable against the dollar during China's NPC. RMB index, however, fell slightly to 95.95 from 96.27 one week ago.	▪ As China's flow picture remained largely balanced, we expect RMB to continue its consolidation mode during the NPC as we don't expect any major announcements about the currency from the meeting.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

This publication is solely for information purposes only and may not be published, circulated, reproduced or distributed in whole or in part to any other person without our prior written consent. This publication should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities/instruments mentioned herein. Any forecast on the economy, stock market, bond market and economic trends of the markets provided is not necessarily indicative of the future or likely performance of the securities/instruments. Whilst the information contained herein has been compiled from sources believed to be reliable and we have taken all reasonable care to ensure that the information contained in this publication is not untrue or misleading at the time of publication, we cannot guarantee and we make no representation as to its accuracy or completeness, and you should not act on it without first independently verifying its contents. The securities/instruments mentioned in this publication may not be suitable for investment by all investors. Any opinion or estimate contained in this report is subject to change without notice. We have not given any consideration to and we have not made any investigation of the investment objectives, financial situation or particular needs of the recipient or any class of persons, and accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the recipient or any class of persons acting on such information or opinion or estimate. This publication may cover a wide range of topics and is not intended to be a comprehensive study or to provide any recommendation or advice on personal investing or financial planning. Accordingly, they should not be relied on or treated as a substitute for specific advice concerning individual situations. Please seek advice from a financial adviser regarding the suitability of any investment product taking into account your specific investment objectives, financial situation or particular needs before you make a commitment to purchase the investment product. OCBC and/or its related and affiliated corporations may at any time make markets in the securities/instruments mentioned in this publication and together with their respective directors and officers, may have or take positions in the securities/instruments mentioned in this publication and may be engaged in purchasing or selling the same for themselves or their clients, and may also perform or seek to perform broking and other investment or securities-related services for the corporations whose securities are mentioned in this publication as well as other parties generally.

Co.Reg.no.:193200032W