Highlights

It is all about private owned enterprises (POEs) funding. Every headline you see from China whether it is in the State Council meeting or in PBoC's monetary policy report is about how to support POE funding demand. I guess, POE funding is probably one of the most important initiatives in China to celebrate 40th anniversary of reform and opening. POE funding is likely to continue to be the key word in the coming months.

Unfortunately market did not react positively to China's banking regulator's initiative to further push banks to support POE funding after CBIRC announced the quantitative guidelines, which led to concerns that banks may lose control of their own destiny to decide the flows of money, which may in turn lead to higher NPLs. On the positive note, the CBIRC said over the weekend that the quantitative measure is not mandatory and banks' credit standard will not be compromised. This may help calm down market jittery.

In the latest PBoC 3Q monetary policy report, PBoC argued inflation and liquidity trap are unlikely to be the key constraints to China's monetary policy in the coming quarters. Therefore, we think China may continue to ease its monetary policy via targeted RRR cut to support the growth.

On currency, the movement of RMB was mainly the function of dollar movement last week. The stable RMB index last week showed that there is less concern about the idiosyncratic risk from China after PBoC reiterated it will keep RMB under watch. PBoC said it will continue to use the counter cyclical measures to support the currency market if necessary though it did not give the details. This signals that China is unlikely to let currency go despite the tug of war between easing monetary policy and stable currency.

In **Hong Kong,** housing market continued to show signs of slowdown due to the weakening housing sentiments on several unfavorable factors. First, wealth effect subsided as HK stock market tumbled on US-China trade war escalation and the Fed's hawkish stance. Second, fear of rising interest rates is growing as HK's banking system kicked start the prime rate hike cycle in September. Third, salary prospects have turned muted given the increasing signs of economic slowdown in both HK and China. Fourth, housing demand from Mainland investors appeared to have softened, probably due to trade war concerns and the decelerating growth of Chinese economy. Finally, the expectations of increasing public housing supply, following HK 2018 Policy Address, might have shifted the housing demand from private to public sector. All in all, housing transaction may remain sluggish while housing prices may drop around 15% by end-2019 from the record high. Elsewhere, USDHKD hovered around 7.83 last week after tumbling to a more than one-month low of 7.8124 on 2nd November. The HKD's resilience was mainly due to equity inflows and RMB's strong rebound on positive headlines about US-China trade relationship. As such, the wider USD-HKD yield differential did not translate into much downside pressure onto the HKD. Moving into December, we do believe that front-end HKD liquidity will tighten as banks may hoard money for window dressing while market participants may pre-position for possible liquidity crunch and any renewed bets on prime rate hike. If this is the case, we expect 1M HIBOR to go up sharply in December and 3M-1M HIBOR spread to narrow from the current 105bps to 20bps or an even lower level.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ In its 3Q monetary policy report, China's central bank said weighted average funding costs for corporate fell slightly by 0.03% to 5.94% in 3Q as a result of easier monetary policy. ▪ Meanwhile, PBoC reiterated its commitment to support financing for private owned companies. ▪ Looking ahead, PBoC said its policy will remain forward looking and pre-emptive to support a stable macro backdrop.	▪ PBoC published a special column discussing China's inflation outlook. Despite the rebound of China's CPI driven by rising food prices and rental prices, it seems that PBoC is not concerned about the inflation outlook due to potential falling demand as a result of rising external uncertainties. Meanwhile, the increasing domestic supply of goods as manufacturer may shift their product offering from export to domestic trade due to trade war may also cap the price pressure domestically. ▪ In addition, PBoC denied the rising concern that China may fall into the liquidity trap after it argued that the decline of excessive reserve placed by banks with the central bank shows that the liquidity has been channelled to the real economy. ▪ As such, inflation and liquidity trap are unlikely to be the key constraints to China's monetary policy in the coming quarters. Therefore, we think China may continue to ease its monetary policy via targeted RRR cut to support the growth.

	▪ On currency, PBoC said it will continue to use the counter cyclical measures to support the currency market if necessary though it did not give the details. This signals that China is unlikely to let currency go despite the tug of war between easing monetary policy and stable currency. ▪ Last but not least, it seems that PBoC may continue to fine tune the macro prudential assessment framework to encourage banks to increase their financial support to small companies and private owned companies. This is likely to the be key theme in the coming quarters but may raise the concern about the loan quality in the financial system.
▪ China stepped up its funding support to private owned economies with China's banking regulator CBIRC announced a new "125" quantitative target for banks to support the POE funding. ▪ For big banks, lending to POE should account for no less than one third of total new lending while for medium and smaller banks, lending to POE should account for no less than two thirds of total new lending. Meanwhile, within the next three years, about half of new loan are expected to go to POEs. ▪ In order to calm down market concern that the new measures may raise non-performing loan ratio in the financial system, the CBIRC said the quantitative measure is not mandatory and banks' credit standard will not be compromised.	▪ The new 125 measure is a surprise to market. However, it does show that support to private owned companies could be the most important task to celebrate China's 40th anniversary of reform and opening. ▪ Previously, there are about four ways for China to support POE borrowing. First, an easing monetary policy is needed to guarantee liquidity to support POE funding. Second, PBoC will expand its qualified collateral to include POE loan and bonds for its open market operation and monetary tools such as MLFs. Third, China may also revise the macro prudential assessment framework to give those supporting POE lending a higher score to incentivize banks. Fourth, China will also set up tools to support bond issuance by POEs. ▪ Those four measures are more like indirect measures while the 125 measure is more like direct measure, which may raise concern that banks may lose control of their own destiny to decide the flows of money, which may in turn lead to higher NPLs. ▪ Clearly, the reassurance from the CBIRC that the number is not mandatory is helpful to calm down the jittery.
▪ China concluded its first import exhibition. According to China, total US$57.8 billion transaction has been inked. ▪ In the opening of import exhibition last Monday, China's President Xi reiterated China's commitment to open its market to the world. Meanwhile, President Xi also announced to import US$40 trillion goods and services in the next 15 years.	▪ China's plan to import about CNY40 trillion goods and services works out to be about US$2.7 trillion per annum on average. This is not a small number. China total imported about US$2.2 trillion goods and services under Balance of Payment in 2017. The number is expected to increase further to around US$2.6 trillion this year. China's plan to further boost imports for the next 15 years shows China's commitment to open its market. ▪ Nevertheless, the number also raised two questions. First, how will China finance its large purchase ever year given China's FX reserve was only at US$3 trillion? Second, what's the impact on China's balance of payment should import growth outpace export growth against the backdrop of trade war? ▪ We think, in the longer run, China may still need to run a strong currency policy to finance its large purchase of goods and services. Nevertheless, in the short run, China's shrinking current account surplus may create the pressure for RMB to weaken. As such, China may still need to find a balance between its long term plan and short term impact.
▪ USDHKD hovered around 7.83 last week after tumbling to a more than one-month low of 7.8124 on 2nd November.	▪ The HKD's resilience was mainly due to equity inflows and RMB's strong rebound on positive headlines about US-China trade relationship. As such, even though 1M HIBOR dropped notably by 125bps from September's high to 1.025%, the wider USD-HKD yield differential did not translate into much downside pressure onto the HKD. ▪ However, with market shifting the focus from US mid-term

	election to Fed's rate hike trajectory, global equity markets lost momentum again. In this case, it is likely for the HKD to wipe out some gains, especially given the rally of broad dollar. Besides, in the coming sessions, we expect 1M HIBOR to hover around current levels amid flushed liquidity. This may boost carry trade activities and weigh down the HKD. However, fears of funding crunch in December may keep short HKD traders cautious. Therefore, USDHKD may not touch 7.85 in the near term. ▪ Moving into December, we do believe that front-end HKD liquidity will tighten as banks may hoard money for window dressing while market participants may pre-position for possible liquidity crunch and any renewed bets on prime rate hike. If this is the case, we expect 1M HIBOR to go up sharply in December and 3M-1M HIBOR spread to narrow from the current 105bps to 20bps or an even lower level.

Key Economic News

Facts	OCBC Opinions
▪ China's FX reserve fell to US$3.053 trillion in October, down from US$3.087 trillion in September.	▪ The decline of FX reserve was partially the result of valuation effect as dollar index rebounded in October. However, there is also sign that capital outflow may have accelerated as a result of persistent RMB weakness.
▪ China's October trade data remained strong less affected by US-China trade war. Both export growth and import growth accelerated to 15.6% and 21.4% yoy from 14.5% and 14.3% in September.	▪ China's trade surplus with the US remained sizable in October at US$31.8 billion with China's export to US grew steadily at 13.2% albeit the new tariff rate on US$200 billion goods took effect from late September. This is probably due to ongoing frontloading activities by Chinese exporters due to concern about the potential adjustment of tariff rate to 25% from 10% from 2019. ▪ On the positive note, the demand from China's major trading partners such as EU, Japan and ASEAN remained strong. This may help alleviate pressure from the uncertain outlook from the trade war. ▪ The strong import growth was mainly the result of rising demand for commodity with import of crude oil and iron ore by value rose by 89% and 11.7% yoy respectively.
▪ China's October inflation was largely in line with market expectation. CPI hovered at 2.5% intact from Septemer's level while PPI decelerated further to 3.3% from 3.6%.	▪ China CPI trended higher driven by food and rental prices. There is the risk that CPI may continue to go higher in the coming months. However, we think the CPI is likely to stay well below the target of 3%. In addition, the weak demand prospect as a result of rising uncertainty and increasing domestic supply due to trade war may cap the upside for China's inflation outlook. ▪ For PPI, the growth is expected to decelerate further in the coming months due to base effect. We expect PPI to fall below 3% in December.
▪ HK's exchange funds gained HK$1.6 billion in 3Q 2018 after exhibiting a loss of HK$7.7 billion in the previous quarter.	▪ The USD's sustained strength continued to result in foreign exchange losses of HK$16.2 billion. Besides, local stock investments recorded another loss of HK$4.7 billion mainly due to the stock market fell on China's economic slowdown and the escalating US-China trade tensions. On a positive note, overseas stock investments and bond investments gained HK$12.8 billion and HK$9.7 billion respectively in 3Q18. Moving ahead, we expect the exchange funds to show subdued performance in the coming quarters. First, foreign exchange losses are unlikely to

	recover in the near term as the broad dollar's strength may sustain into early 2019. Second, bond investments are likely to see some losses as the Fed's hawkish stance pushed 10-year US Treasury Yield to the highest level since 2011 at 3.23%. Third, global equity markets will also take a hit amid the Fed's gradual tightening, US-China trade war escalation and the diminishing chances of tax reform 2.0 in the US. Nonetheless, the sizeable exchange fund (currently HK$4.03 trillion as at the end of September 2018, much stronger than the HK$0.91 trillion as of end-1998) could allow the HKMA to well maintain the linked exchange rate system.
▪ HK's housing market continued to show signs of slowdown. Total housing transaction volume tumbled for the second straight month by 19.8% yoy to 4243 deals in October. Approved new residential mortgage loans slid notably by 33.8% mom to HK$31.6 billion in September. The number of new applications for residential mortgage also plunged by 55.6% mom to 7977 in September. Both reached the lowest since December 2017. Though property developers offered sweeteners, primary housing transaction volume continued to tumble. Worse still, residential property price index dropped for the second consecutive month by 1.4% mom in September and was down by 1.5% from the all-time high. In the secondary market, home sellers increasingly lowered the offering prices, normally by 10% to 20%, in an effort to find a potential buyer.	▪ The disappointing data prints clearly point to weakening housing sentiments on several unfavorable factors. First, wealth effect subsided as HK stock market tumbled on US-China trade war escalation and the Fed's hawkish stance. Second, fear of rising interest rates is growing as HK's banking system kicked start the prime rate hike cycle in September. Third, salary prospects have turned muted given the increasing signs of economic slowdown in both HK and China. Fourth, housing demand from Mainland investors appeared to have softened, probably due to trade war concerns and the decelerating growth of Chinese economy. The transaction volume of private homes valued over HK$10 million dropped by 26% yoy to the lowest since January 2017 at 709 deals in October. Finally, the expectations of increasing public housing supply, following HK 2018 Policy Address, might have shifted the housing demand from private to public sector. All in all, housing transaction may remain sluggish while housing prices may drop around 15% by end-2019 from the record high.
RMB	
Facts	**OCBC Opinions**
▪ The support RMB received from the US mid-term election failed to sustain after dollar rebounded. ▪ The USDCNY ended above 6.95 last week. However, RMB index remained stable at the current stage.	▪ The movement of RMB was mainly the function of dollar movement last week. The stable RMB index last week showed that there is less concern about the idiosyncratic risk from China after PBoC reiterated it will keep RMB under watch. Market will continue to watch out for the headline regarding US-China trade deal in the upcoming G20 meeting.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Co.Reg.no.:193200032W