Highlights

Last week was relatively a quiet week for China. Market focus shifted to China's April economic data due to lack of news flows on trade talk. China's trade data beat market expectation in April as it could be distorted by frontloading activities in anticipation of potential tariff hit in early June. Interesting to note, China's trade surplus with the US widened to US$22.19 billion from US$15.4 billion in March. Surprisingly, the wider trade surplus did not trigger the harsh tone from President Trump. Instead, Trump's rosy twitter about ZTE on Sunday gives market hopes on the de-escalation of US-China trade tension, although there is no updated regarding Liu He's trip to Washington this week.

China's aggregate credit expansion stabilized in April after eight month's consecutive decline. Credit supply continued to shift from off-balance sheet to on-balance sheet and direct financing, which is in line with government's target. One worrying trend from the April credit data is that household deposit fell by a record high of CNY1.32 trillion due to competition from wealth management product and money market fund. In PBoC's 1Q monetary policy report unveiled last Friday, the central bank reckoned the impact of two-tier interest rate system on bank's liability. It said the current two-tier interest rate system has led to the outflows of bank deposits, which resulted in shorter duration of bank's liability. This has forced banks to rely more on interbank funding which destabilized the funding. As such, merge China's two-tier interest rate system is the goal of China's central bank in the near term.

Other than two-tier interest rate systems, the latest PBoC 1Q monetary policy report showed that weighted average loan rate increased by 22bps to 5.96% in 1Q. This confirms our previous concern that the higher interbank funding costs arising from China's de-leverage efforts has been transmitted to the real economy. This is likely to further weigh down China's growth prospect. On financial regulation, the PBoC will continue to tighten its macro prudential assessment by applying the NCD issuance assessment to all banks including smaller banks with asset size less than CNY500 billion from 1Q 2019.

On currency, the PBoC reiterated to allow market to play a bigger role in deciding currency value, a sign of less intervention. RMB strengthened last week after broad dollar rally paused. The near term RMB outlook may still depend on dollar movement. The potential de-escalation of US-China trade tension following Trump's twitter on ZTE may lead to gains of RMB.

In Hong Kong, liquidity condition diverged between short-end and long-end with the gap between 3-month HIBOR and 1-month HIBOR widening to the largest since 2008 at 70bps. On a positive note, market players appeared to have been calming down before liquidity squeezing events including quarter-end, Fed's possible June rate hike, dividend payout flows and Xiaomi's IPO materialize. 3-month HIBOR came off 0.5 bps on 11 May after rising consecutively for nine days. We expect interbank rates to retrace moderately in the coming weeks. Due to ample liquidity, the possibility of USD/HKD spot rate staying at 7.85 cannot be ruled out. However, owing to concerns about tighter liquidity in the coming months, short HKD traders are much more cautious than they were in April. As such, the size of short HKD positions is expected to be rather small, which may not cause any FX intervention of the HKMA or may only reduce the aggregate balance slightly. Moving into June, 1-month HIBOR is expected to catch up with 3-month HIBOR and its US counterpart. Given a narrower US-HK yield differential, USD/HKD may retreat to around 7.84. Elsewhere, 1Q18 GDP expanded 4.7% yoy, the strongest pace since 2Q11, mainly attributed to resilient external demand and domestic consumption. Moving forward, we expect strong external and internal demand will continue to bolster the economy. However, should US-China trade tensions escalate, trade activities may take a hit in 2H18. Besides, expected interest rates hikes in 2H18 could weight down wealth effect and in turn soften the growth of household spending. Adding on high base effect, we expect GDP growth to moderate in the coming quarters. Still, given the strong momentum in 1H18, we revise our forecasts for 2018 GDP growth from 2.9% yoy to 3.6% yoy.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ PBoC unveiled its first quarter monetary policy report. Hot issues such as RMB internationalization, interest rate mechanism and China's macro leverage has been mentioned in the report.	▪ A few highlights from PBoC reports. ▪ First, funding costs increased across the board. The weighted average loan interest rate increased to 5.96% in March, up 22bps from 2017. In addition, 9.94% more loans in the first quarter have been priced at the cost above benchmark interest rate. This confirms our previous concern that the higher interbank funding costs arising from China's de-leverage efforts has been transmitted to the real economy. This is likely to further weigh down China's growth prospect. ▪ Second, RMB internationalization has been back to policy

	maker's radar after the stabilization of China's capital flows. According to the PBoC data, total RMB denominated cross border payment surged by 113% in 1Q while total RMB denominated cross border receipt also jumped by 65.4%. The PBoC said it will continue to improve RMB cross border policy framework and optimise the related infrastructure to support the increasing usage of RMB in the international market. ▪ On interest rate, the PBoC reiterated its plan to eventual merge two tier interest rate pricing to one standard rates. The current two-tier interest rate system has led to the outflows bank deposits, which resulted in shorter duration of bank's liability. This has forced banks to rely more on interbank funding which destabilized the funding. As such, PBoC will continue to solve this problem via improvement of benchmark rate SHIBOR as well as tighten its supervision on wealth management products. ▪ On leverage ratio, the PBoC said total non-financial corporate leverage fell by 0.7% to 159% in 2017, first decline since 2011. In addition, government leverage ratio also fell by 0.5% to 36.2% in 2017. The PBoC expect the leverage ratio to stabilize and fall gradually. ▪ On financial regulation, the PBoC will continue to tighten its macro prudential assessment by adding the certificate of deposits issued by financial institutions with asset size less than CNY500 billion into the MPA. ▪ Last, on currency, the PBoC reiterated to allow market play a bigger role in deciding currency value, a sign of less intervention.
▪ President Trump's twitter on Sunday to allow ZTE back to business shows ease of US-China trade tension.	▪ Although it was reported by media that Liu He's trip to Washington this week may be postponed, Trump's latest twitter on ZTE gives market hope that Trump may have gotten what he wants from China side, at least partially. This also explains this morning's move of USDCNH to below 6.3300.
▪ HK's liquidity condition diverged between short-end and long-end. Front-end liquidity remains flushed with 1-month HIBOR coming off from 1.31% to 1.05%. In contrast, longer-end liquidity tightened as market players have been pre-positioning for June and July when a range of factors will likely cause liquidity squeeze. As a result, the gap between 3-month HIBOR and 1-month HIBOR widened to the largest since 2008 at 70bps.	▪ On a positive note, market players appeared to have been calming down before liquidity squeezing events including quarter-end, Fed's possible June rate hike, dividend payout flows and Xiaomi's IPO materialize. 3-month HIBOR came off 0.5 bps on 11 May after rising consecutively for nine days. We expect interbank rates to retrace moderately in the coming weeks. Due to ample liquidity, the possibility of USD/HKD spot rate staying at 7.85 cannot be ruled out. However, owing to concerns about tighter liquidity in the coming months, short HKD traders are much more cautious than they were in April. As such, the size of short HKD positions is expected to be rather small, which may not cause any FX intervention of the HKMA or may only reduce the aggregate balance slightly. Moving into June, 1-month HIBOR is expected to catch up with 3-month HIBOR and its US counterpart. Given a narrower US-HK yield differential, USD/HKD spot rate may retreat to around 7.84.
▪ The IMF's resident representative in Hong Kong states that HK's home prices is unlikely to be crashed by rate hikes given structural imbalance between supply and demand.	▪ In fact, we expect HIBOR to go up gradually this year while prime rate will be lifted by a total of 50 bps this year. As such, prospects for higher borrowing costs are likely to decelerate housing market growth. However, we also do not expect housing market to crash due to several reasons. Firstly, data shows that only 51% of the primary home transactions have been financed by mortgage loans so far this year. This indicates that affluent households who believe in the prolonged undersupply of housing will likely continue to enter the market despite rate hikes. Secondly, due to the long waiting time to get a public

	housing unit and the increasing unaffordability of private flats, there has been huge pent-up housing demand in HK. The growth of domestic households accelerated from an average of 1.2% during 2008-2016 to 1.4% in 2017. However, owner-occupiers as a proportion of total number of domestic households only marked 49.2% in 2017, down from an average of 52% during 2008-2016. Huge pent-up demand could help to cap the downside for the housing market. Thirdly, property developers may choose to sell their new project at a slow pace in anticipation of a weakening housing market. In all, we expect secondary housing price growth to slow down gradually from 15% yoy in March to 0%-3% by end of this year.
▪ MSCI will include China A-shares in its emerging-market index starting 1 June and the weighting will be 2.5%. Starting 3 September, the weighting will be increased to 5%.	▪ Market players appeared to have been pre-positioning for MSCI's inclusion of China A-shares. Northbound net inflows under the two stock connects reached the record high of RMB 40.5 billion in April 2018. With the daily northbound quota under both Shenzhen-Hong Kong stock connect and Shanghai-Hong Kong stock connect quadrupling to RMB 52 billion starting 1 May, northbound net inflows increased at a strong pace. The month-to-date amount totaled RMB 14.57 billion. Compared with RMB 9.25 billion of southbound net inflows after quota expansion, it is clearly that A-shares have been more attractive. There could be two impacts to the market. On the one hand, more equity flows into Mainland China will likely support the RMB. On the other hand, however, equity flows out of HK may lead to a tighter liquidity and add upward pressure onto HIBOR. As such, commercial banks may be pressured to raise HKD deposit rates to ease funding pressure and lift prime rate to avoid mortgage net-interest-margin from narrowing further.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's trade data beat market expectation in April with both exports and imports growth reaccelerated to 12.9% yoy and 21.5% yoy from the contraction of 2.7% yoy and 14.4% yoy respectively. Trade surplus widened to US$28.78 billion from a deficit of US$4.98 billion in March.	▪ The recovery of trade data in April was mainly attributable to two reasons. First, seasonal effect from the late Chinese New Year this year has dissipated. Second, it could also be distorted by frontloading activities in anticipation of potential tariff hit in early June. ▪ Interesting to note, China's trade surplus with the US widened to US$22.19 billion from US$15.4 billion in March, highest in 2018. This may again fuel more harsh tones from the US for the upcoming negotiation. ▪ On breakdown, the rebound of demand for Chinese goods is broad based. Exports to EU and Japan increased by 10.9% and 9.6% respectively while exports to ASEAN surged by 17.7% yoy. ▪ On imports, China's demand for commodity remained strong in April with imports of crude oil rose by 42.9% yoy in dollar term and 14.7% yoy in volume term. On the positive note, China's imports of electronic integrated circuit remained strong at 35.5%, less affected by trade tension. The strong EIC imports may remain supportive of China's exports in the coming months.
▪ China's April FX reserve fell by US$18 billion to US$3.125 trillion. However, FX reserve in SDR term rose by 11.26 billion to 2.17 trillion.	▪ The decline of FX reserve in April was mainly the result of valuation effect as dollar index rebounded by more than 2% in April. However, the rebound of FX reserve in SDR term shows that overall capital flow remained balanced and there is no concern about imminent capital outflow risk.

▪ China's CPI decelerated to 1.8% yoy in April from 2.1% yoy in March as a result of weaker than expected food prices. ▪ China's PPI, however, recovered to 3.4% in April from 3.1% in March.	▪ Since the beginning of the year, pork price has fallen by about 30%. The impact of higher oil prices may have been offset by the weaker food prices. We think inflationary pressure is likely to remain muted in the coming months due to weak food prices. Nevertheless the low base effect, which is expected to peak in June, is likely to provide the floor for CPI. We expect CPI to hover around the current level for the coming months. ▪ We think China's PPI may have bottomed in March and is expected to rise slightly in the coming months on the back of low base effect. We expect PPI to stay between 3.5% and 4% in the second quarter.
▪ China's aggregate credit expansion stabilized in April after eight month's consecutive decline. Total outstanding of aggregate social financing rose by 10.5% in April, unchanged from that in March. From flow perspective, aggregate social financing increased by CNY1.56 trillion while new Yuan loan increased by CNY1.18 trillion, in line with market expectation. ▪ Broad money supply M2 growth rebounded slightly to 8.3% in April from record low of 8.2% in March.	▪ Credit supply continued to shift from off-balance sheet to on-balance sheet and direct financing, which is in line with government's target. Entrusted loan and trust loan fell by CNY148.1 billion and CNY9.4 billion in April respectively. The decline was partially offset by the rebound of banker's acceptance. The direct financing including bond and equity increased by CNY430.9 billion, highest since November 2016. The bond market activity revived after the recent bull run in the bond market. ▪ On RMB loan, medium to long term loan demand remains healthy for both household sector and corporate sector. Total medium to long term loan increased by CNY821.1 billion, accounting for about 70% of total loan demand. ▪ On deposit, total RMB deposit increased by CNY535.2 billion, however, household deposit fell by a record high of CNY1.32 trillion due to competition from wealth management product and money market fund.
▪ HK's 1Q18 GDP expanded 4.7% yoy, the strongest pace since 2Q11, mainly attributed to resilient external demand and domestic consumption.	▪ Externally, owing to sustained global economic growth as well as a weaker HKD, exports of goods grew by 5.2% yoy, the strongest pace since 3Q17. Exports of travel services expanded remarkably by 11.8% yoy, in line with buoyant inbound tourism (total visitor arrivals increased 9.6% yoy during 1Q18). Exports of financial services surged 10.7% yoy, supported by strong financial activities across the globe. Domestically, private consumption advanced 8.6% yoy, the fastest pace since 3Q11. This is mainly due to wealth effect from a resilient stock market and booming housing market. A tight labor market with a twenty-year low unemployment rate and benign real wage growth has also boded well for consumer sentiment. Furthermore, expansionary fiscal policy has supported government consumption and public investment to increase by 3.9% yoy and 10.5% yoy. Moving forward, we expect strong external and internal demand will continue to bolster the economy. However, should US-China trade tensions escalate, trade activities may take a hit in 2H18 as HK is the major re-export port of China. Besides, prospects for higher interest rates in 2H18 could weight down wealth effect and in turn soften the growth of household spending. Adding on high base effect, we expect GDP growth to moderate in the coming quarters. Still, given the strong momentum in 1H18, we revise our forecasts on 2018 GDP growth from 2.9% yoy to 3.6% yoy.
▪ Macau's housing transactions reduced notably by 57.6% mom or 39.1% yoy to 644 deals in March. In contrast, average housing price advanced 8.4% yoy to MOP 99543/square meter after gaining 24.7%	▪ The data prints indicate that government's property control measures have been effective. Specifically, the removal of exemption of vacant residential property tax and the additional stamp duty on second-home buyers have curbed housing

yoy in the previous month. Approved new mortgage loans jumped by 133.9% mom or 47.1% yoy to MOP6.08 billion.	demand as well as secondary home supply. As a result, housing transactions are expected to remain sluggish in the coming months. ▪ On the other hand, new measure allows local first-home buyers to apply for mortgage with loan-to-value ratio up to 90%. As such, pent-up demand has translated into resilient housing prices and notable growth in mortgage loans. Moving forwards, buoyant economic outlook will bode well for the labor market. Positive earnings prospects will in turn lend more supports to first-home buyers. On the supply front, housing completion decreased by 52% yoy to 247 units while housing start fell by 88% yoy to 338 units in 1Q 2018. Scarce home supply combined with strong demand from first-home buyers will likely keep housing prices elevated. Nevertheless, we expect higher borrowing costs and potential stock market correction will cap the upside for housing prices.

RMB	
Facts	**OCBC Opinions**
▪ RMB rebounded against the dollar last week after dollar strengthen paused following the slightly weaker than expected US April CPI data.	▪ RMB index strengthened slightly to 97.59. We expect the movement of RMB will depend on the broad dollar trend with appreciating bias.

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