Highlights

As expected, President Trump signed the new Taiwan Travel Act into law, which added more uncertainty to US-China bilateral relationship. As expected, Trump's new economic advisor blasted China, a sign that the trade tension is likely to escalate further. As expected, Wang Qishan was elected as China's Vice President, reinforcing President Xi's power. Nevertheless, Mr. Wang is facing a tough start for his job as China's key negotiator for US-China relationship as the bilateral relationship is deteriorating at a faster than expected pace ahead of the US midterm election.

What is not expected is that Yi Gang is tipped to succeed Zhou Xiaochuan as the new PBoC Governor according to the Wall Street Journal as Mr. Yi holds relatively a low political ranking as the alternative member of China's 19th CPC Central Committee. The result will be out soon early this week. Nevertheless, regardless of who will be the new PBoC chief, it will not change PBoC's transition towards a super central bank model after the latest proposal of financial regulatory overhaul shows that China will move law making power to PBoC from newly formed China banking and insurance regulatory commission. A super central bank, by definition, will be responsible for three areas including monetary policy setting, macro prudential and micro prudential in our view. The idea that the PBoC will be responsible for the appointment of senior role for China's major financial institutions shows that the latest overhaul will grant PBoC power to impose micro prudential measures.

On economy, China kicked off 2018 with a strong start. The key economic activities indicators in the first two months beat market expectation. However, both manufacturing production and investment growth decelerated in the first two months, which are a bit worrying sign. Infrastructure investment also slowed but was partially offset by the private investment. Whether the rebound of fixed asset investment is sustainable will probably depend on the outlook of private investment.

In **Hong Kong,** the latest quarterly report of Bank for International Settlements (BIS) points out that HK saw both the credit-to-GDP gap and the debt service ratio gap flashing red. The report warns the rapid increase in loans to property developers in HK. According to the data from HKMA, loans for use in property development and investment accounted for 53.9% of total GDP as at the end of 2017, much higher than the average of 31.6% during 1988-2017. Besides, total household debt to GDP rose to its record high at 69% as at the end of 2017. This makes Hong Kong vulnerable to higher interest rates and property market correction which impairs the debt servicing capacity of property developers and households. Nevertheless, with HKMA having unveiled eight rounds of prudential measures, systematic risk related to the real estate sector may remain well contained. Elsewhere, March FOMC and quarter-end effect may push one-month HIBOR towards 0.8%. However, as fundamentals are barely changed, capital outflow risks may remain well contained. Ample liquidity is likely to persist and HIBOR will likely stay low for some time. As such, we do not expect the banking system to follow the Fed to lift prime rate in March. In **Macau**, housing market performed robustly in January and may remain elevated. The new control measures will curb investment demand and reduce secondary home supply while the new supportive measure will increase the demand from first-home local buyers. This combined with slow increase in both public and private new home supply is expected to limit the upside for housing transactions whereas underpinning housing prices.

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China will merge banking regulator CBRC and insurance regulator CIRC to form a new regulatory body China banking and insurance regulatory commission (CBIRC).
In addition, the authority for drafting regulation and oversight rules will be moved to PBoC.

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One of the key purposes of financial regulatory overhaul in China is to split law making from supervisory role. PBoC will take a bigger role to provide holistic financial regulatory framework while the newly formed China banking and insurance regulatory commission will execute the oversight role on the micro level.
The change shows that PBoC is being empowered as a super central bank, in our view, as a super central bank will be responsible for three key areas including monetary policy setting, macro prudential and micro prudential. Among all, macro prudential is designed to contain the financial risk in the whole financial sector while micro prudential will help keep important financial institutions sound and crisis proof. Since 2016, the PBoC has adopted a macro prudential assessment framework to keep systemic risk in check. The latest regulatory overhaul will give PBoC the power to impose micro prudential as well.
Although the whole change still lacks of details, the latest article from PBoC research director Xu Zhong shows that the central

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	bank is likely to be granted power to be responsible for the appointment of senior position in major financial institutions. This will in turn gives PBoC power to impose micro prudential measures. ▪ We see two possible implications of this super central bank model in the near term. First, as the consolidation may take some time, we don't expect more regulatory tightening in the near term. Second, as PBoC tends to be more international and open-minded, the consolidation of law-making power may not be bad news for foreign investors.
▪ The PBoC net injected CNY377.5 billion last week via both reverse repo and MLF.	▪ The conduction of CNY327 billion MLF exceeded market expectation as only CNY189.5 billion expired last week. The higher than expected MLF injection shows PBoC's commitment to market stability to ease quarter-end funding volatility.
▪ The latest quarterly report of Bank for International Settlements (BIS) points out that HK saw both the credit-to-GDP gap and the debt service ratio flashing red. The credit-to-GDP gap and the debt service ratio gap of HK were the highest among major regions and reached 30.8 and 6.9 respectively as of Sep 2017. China ranks the second with the credit-to-GDP gap and the debt service ratio marking 16.7 and 5.1 respectively.	▪ The report warns the rapid increase in loans to property developers in HK. Robust performance of the property market has encouraged property developers to acquire lands and develop real estate projects aggressively. ▪ According to the data from HKMA, loans for use in property development and investment accounted for 53.9% of total GDP as at the end of 2017, much higher than the average of 31.6% during 1988-2017. Besides, total household debt to GDP rose to its record high at 69% as at the end of 2017. The surge in indebtedness increased the debt service ratio. This makes Hong Kong vulnerable to higher interest rates and property market correction which impairs the debt servicing capacity of property developers and households. ▪ Therefore, we remain wary of global monetary tightening which could trigger an increase in HK's local interest rates and result in housing market correction. Nevertheless, with HKMA having unveiled eight rounds of prudential measures, systematic risk related to the real estate sector may remain well contained.
▪ HK's Financial Secretary Chan Mo Po said the government is considering imposing tax on vacant homes. He also pointed out that around 9500 completed flats remained unsold by end of 2017.	▪ According to HK Rating and Valuation Department, over 43000 units were vacant in 2016, representing 3.8% of total private housing units. In fact, the government of Victoria, Australia and that of Vancouver, Canada just introduced taxes on empty homes. The same is true to Macau. However, we doubt the effectiveness of such a property cooling measure as the vacancy rate in 2016 was lower than the average of 4.6% during 1985-2016. It seems like shortage of new homes are the main culprit of the overheated housing market. Therefore, instead of introducing tax on empty homes or some other property cooling measures, the government should focus more on increasing land supply and new home supply at a faster pace.

Key Economic News

Facts	OCBC Opinions
▪ China kicked off 2018 with a strong start. The key economic activities indicators in the first two months beat market expectation. ▪ Industrial production and fixed asset investment accelerated to 7.2% yoy and 7.9% yoy from 6.6% and 7.2% in 2017 respectively. ▪ Retail sales growth remained steady up by 9.7% yoy in the first two months.	▪ Despite mild deceleration of manufacturing production to 7% from 7.2% in 2017 probably due to Chinese New Year effect, the rebound of overall industrial production was driven by mining production and electricity production. The recent strong trade data shows that industrial production growth may remain steady in the coming months. ▪ On investment, the slowdown of infrastructure investment was partially offset by strong private investment, which accelerated to 8.1% yoy from 6% in 2017. We expect China's infrastructure

	investment to slow further in the coming months. As such, whether the rebound of fixed asset investment growth is sustainable depends on the outlook of private investment.
▪ China's central bank net purchased CNY4.1 billion worth of foreign currency in February.	▪ The second consecutive month of net purchase of foreign currency in Feb shows that the decline of China's FX reserve was mainly the result of valuation effect and China's capital flow is relatively balanced. As such, there is no concern for the return of disorderly capital outflows after China removed the capital control measures.
▪ China cut its US Treasury holdings in January to US$1.168 trillion from US$1.185 trillion in 2017, lowest since July 2017.	▪ As trade tensions between US and China heightened, market will closely monitor whether China will use US Treasury as the weapon to retaliate. As we mentioned in the past report that we think this risk is low.
▪ According to HK's Insurance Authority, in respect of policies issued to Mainlanders by HK insurers, new office premiums in 2017 decreased by 30.1% yoy to HK$50.8 billion, representing 32.6% of the total new office premiums for individual business.	▪ This reveals that capital flows between Mainland China and Hong Kong have been well managed. Improved outlook of the RMB also discourages Mainland investors from scrambling for offshore financial products denominated in foreign currencies like USD. Moving forward, we expect risks for RMB will tilt to the upside as potential trade conflicts will likely lead to a softer greenback. If this is the case, further opening up of onshore market will encourage foreign investors to increase holding of RMB assets. Therefore, we expect China's cross-border capital flows to remain balanced this year.
▪ Macau's housing transactions increased notably by 106.6% yoy (85% mom) to 1465 deals while approved new mortgage loans also grew 4% yoy (14.9% mom) to MOP3.63 billion. Furthermore, average housing prices jumped 38.7% yoy (28% mom) to MOP124,481 / square meter.	▪ The housing market's robust performance could be attributed to several factors including wealth effect from bullish stock market, a stable labor market and a retreat in borrowing costs. Besides, as government warned that it would tighten the control on property market, real estate developers launched their projects at a faster pace and offered a wide range of promotions to lure potential buyers. ▪ Looking ahead, housing market is expected to remain elevated. With regard to supportive measure, the government allows first-home local buyers aged between 21 and 44 to apply for a mortgage with loan-to-value ratio up to 90%. This will support first-home local buyers and increase housing demand. In terms of control measures, the government cancels the exemption of vacant residual property tax and adds stamp duty on non-first-home buyers. This is expected to suppress investment demand and reduce secondary home supply. Adding on slow increase in both public and private new home supply, the upside for housing transactions may be limited whereas housing prices may be supported. Still, potential interest rate increase and stock market correction in the medium term may help to moderate the housing market growth.

RMB	
Facts	**OCBC Opinions**
▪ Another stable week for RMB with the RMB index hovering around 96.00 level.	▪ The rumoured appointment of Yi Gang as the new central bank Governor shows the possible continuation of China's currency policy.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Co.Reg.no.:193200032W