Highlights

A perfect risk-on story for China. China's equity market outperformed on the back of hopes on more capital inflows and reform commitment while China's bond market was under pressure due to concerns that PBoC may want to keep the excessive liquidity in check. This is in line with our last week's assessment that China's bond bull run may pause for now.

The MSCI announced to increase the weight of China A shares in its index further as expected. What's new this time is that it will also include 27 ChiNext listed companies from May 2019 and 167 China A mid cap companies from November 2019. This exceeded market expectation. The expansion is expected to attract more than US$60 billion new allocation from foreign investors.

Meanwhile, China sped up its capital market reform via unveiling the detailed regulation on the new Science and technology innovation board, to support the role of direct financing. In addition, the talk on the potential listing of Beijing Shanghai high speed railway also signals the progress of China's mixed ownership reform. China's commitment to capital market reform may further fuel the positive sentiment in China's equity market.

On trade talk, US trade representative Lighthizer's Congress testimony shows that there is still long way to go to narrow the discrepancy between US and China even though a near term deal could be reached. My main takeaway after watching the testimony is that the bipartisan support for him is very strong. On currency, although he did not give details on the currency pact, his acknowledgement that China did not manipulate the currency down may ease concerns on currency war. We doubt there will be any new mini Plaza accord. RMB continued to trend higher against both dollar and major trading partners. Nevertheless, given currency policy is usually not the focus of National People's Congress, we expect RMB to continue to consolidate in the current range pending on further catalysts.

For the upcoming National People Congress from Tuesday. We will pay attention to eight areas including China's target for major economic indices, fiscal policy in particular fiscal deficit target and local government special bond issuance quota, government bond issuance plan, tax and administrative fees reduction, monetary policy, property policy, "new infrastructure plan" and possible endorsement of new foreign investment law to improve market accessibility for foreign investors.

In **Hong Kong,** GDP growth decelerated to 1.3% yoy in 4Q 2018, weakest since 1Q 2016. The slowdown was mainly due to global monetary tightening, trade war escalation and heightened financial market volatility. We expect GDP growth will weaken from 3% in 2018 to 2.4% yoy in 2019 as global slowdown and the lingering trade tension could continue to weigh down exports of goods, investment and local consumptions. On a positive note, the continuous fiscal stimulus may help to cushion growth. Specifically, according to 2019-20 Budget, the government will increase the operating expenditure by 15.4% yoy with the total recurrent expenditure on education, social welfare and healthcare to exceed HK$250 billion in 2019-20. This indicates that fiscal stimulus will sustain despite the weaker surplus (shrank by over 60% yoy to HK$58.7 billion for FY2018 and to decline further to HK$16.8 billion for FY2019). Elsewhere, due to a dovish Fed, we expect to see limited upside to HKD interest rates including time deposits rates. This may in turn moderate the time deposits growth. In contrast, HKD CASA deposits may rebound on the back of sweeteners offered by banks as well as the rally of asset prices. As such, the percentage share of HKD time deposits in total HKD deposits (41.8%) may show limited upside. The same will be true to HKD loan-to-deposit ratio (86.8%) as HKD loan growth is expected to slow down. In conclusion, we believe that the funding pressure and rate hike pressure on commercial banks may not grow much further this year. In **Macau,** despite the infrastructure improvement, policy risks and external headwinds may continue to loom over the gaming and tourism sectors and drag the GDP growth down from 4.7% in 2018 to 2%-3% in 2019.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ The MSCI announced to increase the weight of China A shares in its index via expanding the inclusion factor from current 5% to 20% in three steps in May, August and November 2019. ▪ In addition to include China A large cap, China A ChiNext will be added from May while China A mid cap will be included from November. Total 253 large and 167 mid cap A shares and 27 ChiNext shares will be in the list. ▪ The percentage of China A shares in the MSCI EM index will increase from 0.8% to 3.3% after three	▪ China's A share was first added into MSCI index from 1 June 2018 with initial inclusion factor at 2.5%, which was subsequently raised to 5% from 1 September 2018. China A-share represented about 0.8% of total MSCI EM index in 2018 and 0.1% of total MSCI global index. The percentage will be raised to 3.3% in November at 20% inclusion factor. In the event of full inclusion factor, China's A-share is expected to account for 16.5% of total EM index. ▪ The inclusion of 27 ChiNext listed companies from May 2019 and 167 China A mid cap companies from November 2019 were earlier than market expected. The expansion is expected to

steps. ▪ The inclusion is based on China's commitment to improve market accessibility as well as the reduction of disruption such as trade halt. ▪ The future increase of weight will depend on the %development of risk management tools as well as improving market accessibility standard.	attract more than US$60 billion new allocation from foreign investors. ▪ As of end of 2018, foreign investors held about CNY1.15 trillion Chinese equities, accounting for about 3.2% of total market cap. Given China plans to further increase its foreign ownership of equities, we may expect more foreign inflows in the coming years.
▪ China will officially begin its National People's Congress from Tuesday.	▪ We will pay more attention to eight areas for the upcoming NPC. ▪ First, China will set its key target for major economic indices. GDP growth for 2019 is expected to be lowered to 6-6.5% range after 23 provinces have downgraded their growth target in their local NPC. Market will closely monitor whether China will set a quantified target for M2 growth, which was omitted last year. ▪ Second, fiscal is always one of the most important elements for the NPC as China will set all the budgets for government expenditure to support long term sustainable growth. Two numbers will be highly watched including the fiscal deficit target and quota for local government special bond issuance. Fiscal deficit target is likely to be set at 2.8%, higher than previous years but lower than market expected 3%. Any fiscal deficit target above 2.8% could be a positive surprise. The local government special bond issuance quota is expected to be raised to above CNY2 trillion from CNY1.35 trillion in 2018. Against the backdrop of standardizing the stealth debt, China may reply more on special bond to stabilize the infrastructure investment growth, which is expected to stay between 5-10%. ▪ Third, based on the assumption of 2.8% fiscal deficit target. We think China's nominal fiscal deficit may go up to about CNY2.8 trillion. Given about 65% of deficit may be funded by central government. Total government bond issuance after taking CNY2.1 trillion maturing profile into account will be close to CNY4 trillion. ▪ Fourth, tax cut and reduction of administrative fees will be one of the key focuses. Should China announce the VAT cut for manufacturing sector by more than 2%, it may boost market sentiment. ▪ Fifth, on monetary policy, the overall tone is expected to repeat the messages from the Central Economic Working Conference last December. China is likely to keep its liquidity stable at a reasonable level. ▪ Sixth, on property market. China may continue to allow local government to set their own policies. As such, we might see some marginal easing on property front. However, given most provinces have lowered their target for revamp of shanty town. Property investment is likely to be capped. ▪ Seventh, "new infrastructure plan" is likely to be the new hot term going forwards. China will push ahead with investments in 5G, artificial investment, internet of things etc as top priority to nurture new growth engine. Although it is still not enough to replace the old growth engine such as investment and property, it may partially make up the loss of growth from the old engine. ▪ Eighth, China may continue to open its domestic market against the backdrop of trade war. China's NPC may approve the new foreign investment law to improve market accessibility to foreign investors.
▪ China sped up its capital market reform to support the role of direct financing.	▪ The activation of new board, one month after the change of head of Security regulator, exceeded market expectation. This

▪ The security regulator and Shanghai Stock Exchange unveiled the detailed regulation on China's Science and technology innovation board, which has taken effect from last Friday.	signals China's commitment to capital market reform. This may further fuel the positive sentiment in China's equity market. ▪ In addition, the news on possible listing of one of the world's most profitable Beijing Shanghai high speed railway also signals that China may speed up the mixed ownership reform to allow private capital to play a bigger role in the economy.
▪ US Trade Representative Lighthizer conducted its Congress testimony last week on US China trade for nearly three hours.	▪ He made very clear that he wants a trade deal with two features including China's structural reform and enforceable. China's purchase plan is good but not enough. In answer to one Congressman's question whether he will accept the deal falling short of the plan as some of companies in their constitutions are badly hurt by the tariff, his answer is quite straight that he will not accept the deal with no structural change. ▪ On currency issue, a few congressmen asked for the details about the currency pact. Lighthizer did not give details. He only said we have spent lots of time on it and the currency deal will be enforceable. Basically, what US wants regarding currency are two things including no competitive devaluation in future and transparency. On the positive note, he thinks the situation is different from 2010 when he accused China as a currency manipulator in the similar testimony. He reckons that China is manipulating the currency up rather than down. This may ease some concerns on currency war. ▪ Although he did not give details on currency, he did elaborate how US will enforce the deal if there is any deal. He said there will be monthly meeting at office director level, quarterly meeting at Vice minister level and semi-annual meeting at minister level. The US will act proportionally and unilaterally if the problem cannot be solved in the meeting. My guess is that should a deal be reached, there might be half-year honey moon period before the Minister level meeting. ▪ One of the fun to watch the US congress testimony for me is to guess the congressman's party (Republican or Democratic) via their questions. However, for this testimony, it is very hard to guess only based on the question they asked. This shows one thing that the bipartisan support for Lighthizer is very strong. The US-China trade relationship could be the only few events currently to unite both parties. This suggests the threat to China's trade is likely to persist for years. What's more, there are also some discussions on potential new tool to handle trade tension on top of the current Section 301 and Section 232.
▪ HK Budget: 2018-19 budget balance came in at a surplus of HK$58.7 billion (2.1% of GDP, down from 5.6% in 2017-18), slightly above the original estimate of HK$46.6 billion. However, the fiscal surplus shrank by over 60% yoy as government revenue fell by 3.8% yoy and government spending expanded by 14.2% yoy for FY2018. The decline in government revenue was mainly due to the stock and property markets corrections which pushed down land premium and stamp duties.	▪ There are several takeaways from the budget. First, due to the sharp decrease in fiscal surplus for the previous fiscal year, the government proposes to cut the total spending on one-off relief measures by 18.2% yoy in 2019-20. Instead, the government will increase the operating expenditure by 15.4% yoy with the recurrent expenditure on education, social welfare and healthcare to exceed HK$250 billion in total in 2019-20. The continuous fiscal stimulus is expected to help cushion HK's slowdown against the backdrop of faltering global growth and lingering trade tension. ▪ Second, against the backdrop of limited land resources and human resources, the government pays high attention to the development of talent-intensive and high value-added industries including high-tech industry and financial industry. Both industries' development could leverage on deeper collaboration across the Greater Bay Area as well as the expansion of Asia's

	high-end consumption. ▪ Third, the government proposes to increase housing supply while stating that they have no intention to withdraw any property control measures at this stage. We also believe that it is too early to call it a bottom on the housing market given faltering global growth, lingering trade war risks, muted wage growth outlook and the prospects of increasing housing supply. ▪ As total revenue and total expenditure are expected to expand by 5% yoy and 13% yoy respectively, fiscal surplus for FY2019 is estimated to shrink further to HK$16.8 billion (0.6% of GDP). Fiscal reserves are penciled at HK$1,178.4 billion by the end of March 2020, representing 39.4% of GDP.

Key Economic News

Facts	OCBC Opinions
▪ China's official manufacturing PMI decelerated further to 49.2 in February from 49.5 in January. ▪ Manufacturing PMI for large corporate rose further to 51.5 from 51.3 while PMI for medium and smaller corporates fell to 46.9 and 45.3 respectively from 47.2 and 47.3.	▪ The deceleration of PMI in Feb was mainly the result of weaker supply as production fell from 50.9 to 49.5, below 50 for the first time since January 2009. This might be due to Chinese New Year effect. On demand, domestic demand improved with new orders rebounded to 50.6 from 49.6. However, external demand remains weak with new export orders softened further from 46.9 to 45.2, implying that weak external demand may continue to weigh down on China's growth. ▪ On price, purchasing price rebounded sharply to 51.9 from 46.3. This may ease concerns on China's deflation risk. PPI is expected to stay above zero in February at 0.1%, intact from January reading. ▪ Lastly, the ongoing recovery of PMI for large enterprises shows that China's easing policies may have taken effect. However, the challenges remain for smaller private owned companies to regain the confidence. China has been working hard to address the funding difficulties faced by private owned companies. This will remain the focus of the policy in the coming months. ▪ On monetary policy, the February reading is unlikely to be the catalyst for further easing. However, the probability of interest rate cut remains live. Watching out for the transmission mechanism from money market to real economy as well as credit spread. Should funding situation remain challenge for private owned companies, the chance for China to eventually move towards an interest rate cut cannot be ruled out though we think there is no urgency for China to do so at the moment.
▪ HK's GDP growth decelerated to 1.3% yoy (weakest since 1Q 2016) in 4Q 2018 from the downwardly adjusted 2.8% yoy in 3Q 2018. The slowdown was mainly due to global monetary tightening, trade war escalation and heightened financial market volatility. As a result, GDP growth softened to 3% in 2018 from 3.8% in 2017.	▪ Though unemployment rate held at an over two-decade low, the rise in local interest rates, the trade war escalation as well as negative wealth effect have hurt local consumer sentiments with private consumption growth decelerating to the lowest since 3Q 2016 at 3.1% yoy in 4Q 2018. ▪ Amid trade war escalation and global economic slowdown, exports of goods dropped for the first time since 1Q 2016 by 0.2% yoy in 4Q 2018. ▪ The increasing external headwinds and fears of higher borrowing costs have put a lid on private investment which dropped for the first time since 3Q 2017 by 4.7% yoy in 4Q 2018. Worse still, public investment also fell at the fastest pace since 1Q 2015 by 8% yoy in 4Q 2018 as public investment in building and construction plunged by 12.9% yoy probably due to the completion of some mega infrastructure projects.

	▪ Moving into 2019, we expect GDP growth will weaken to 2.4% yoy (down from the previous forecast of 2.7% yoy) as global economic slowdown and the lingering trade tension could continue to weigh down exports of goods, investment and local consumptions. On a positive note, the expected increase in government's expenditure and investment will allow some floor to the economic slowdown.
▪ HK's total loan growth slowed further to 3.1% yoy in January 2019.	▪ Despite the rebound in global market sentiment in early 2019, financial activities remained sluggish in HK. First, as trade war started to materialize, trade finance dropped for the fifth consecutive month by 5.8% yoy. Second, loans for use in HK (excluding trade finance) grew at a slower pace by 3.6% yoy as approved new mortgage loans plunging by 26.6% yoy on housing market correction. Third, the growth in loans for use outside of HK softened to 3.8% yoy, the weakest since November 2016. Due to the monetary easing in Mainland China, Chinese companies' demand for offshore loans continued to weaken. In conclusion, as external uncertainties may continue to dent investment and consumption while narrowing USD-RMB yield differential may suppress funding demand from Chinese companies, we expect total loans and advances to see lower single-digit growth in 2019 as compared to last year's 4.4% yoy.
▪ HKD loan-to-deposit ratio retreated from decade-high of 86.9% in last December to 86.8% in January 2019 as HKD loans grew at a slower pace than HKD deposits.	▪ HKD demand deposits and HKD savings deposits rebounded by 0.9% mom and 1.2% mom respectively in January 2019, thanks to recent rebound in asset prices. On the other hand, as commercial banks cut HKD time deposit rates, HKD time deposits merely increased by 1.0% mom. As a result, the percentage share of HKD CASA deposits in total HKD deposits remained unchanged at a nearly decade low of 58.2%. Moving ahead, due to a dovish Fed, we expect to see limited upside to HKD interest rates including time deposits rates. As such, the growth of HKD time deposits may soften further in the coming months. In contrast, HKD CASA deposits may rebound slightly on the back of sweeteners offered by commercial banks as well as the rally of asset prices. As HKD loan growth is expected to slow down, HKD loan-to-deposit ratio may show larger downside than upside. In conclusion, we believe that the funding pressure and rate hike pressure on commercial banks may not grow much further this year.
▪ HK's RMB deposits dropped for the second consecutive month by 2.6% mom to RMB599 billion in January 2019, the lowest level since June 2018.	▪ This was probably due to the cut in RMB deposits rates amid flushed offshore RMB liquidity. Nevertheless, as the expectations of further easing by the PBOC waned recently, banks may not cut RMB deposits rates further in the near term. Adding on the improved outlook of RMB and the increasing offshore demand for onshore RMB assets, we do not see much downside risks on HK's RMB deposits in the coming months.
▪ HK's exports and imports fell by 0.4% yoy and 6% yoy respectively as this year's Lunar New Year came earlier than the previous year.	▪ Exports to and imports from the US dropped by 5.8% yoy and 9.5% yoy respectively while exports to and imports from China slid by 3.9% yoy and 1.6% yoy respectively. However, exporters might have brought forward the exports while postpone the imports amid Lunar New Year. As such, it is possible to see a deeper decrease in exports and a milder decline in imports during February. Therefore, we still need more data to gauge the impact of trade war on HK's trade sector. ▪ Lately, the trade talks between US and China seemed to have made some progress with US President Trump announcing to delay the tariff hike. Nevertheless, global manufacturing PMI

	and other Asian countries' trade activities continued to disappoint. This indicates that the slowing global growth, the lingering trade tension and the existing tariff could remain a drag on the entire electronic value chain in Asia. In January, exports of "office machines and automatic data processing machines" and imports of "electrical machinery, apparatus and appliances, and electrical parts thereof" dropped by 8% yoy and 10.8% yoy respectively. All in all, imports and exports are expected to show low single-digit growth this year.
▪ Macau's GDP growth rebounded from 1.9% yoy in 3Q 2018 to 2.1% yoy in 4Q 2018 as the abated weather effect and the infrastructure improvement helped to ease the impact of external shocks. During 2018 as a whole, GDP growth decelerated from 9.7% yoy in 2017 to 4.7% yoy as economic growth softened in the second half of last year.	▪ Internally, despite a tighter labor market, private consumption expanded by 2.8% yoy in 4Q 2018, the weakest since 3Q 2017 due to trade war concerns as well as sharp correction in asset prices. Worse still, since most of the mega entertainment projects have been completed one by one, investment dropped for the third consecutive quarter by 14.3% yoy with private investment tumbling by 20.4% yoy in 4Q 2018. On a positive note, government expenditure remained resilient growth of 3.4% yoy and continued to help cushion the economic slowdown. ▪ Externally, exports of services advanced by 5.2% yoy in 4Q 2018, the slowest pace since 2Q 2016. Specifically, exports of gaming services and other tourism services grew by 6.7% yoy and 1.4% yoy respectively. Though infrastructure improvement has lent some support to the gaming and tourism activities, these two sectors were still succumbed to external shocks including global monetary tightening, China's slowdown and trade war escalation. ▪ Moving forward, China's tightening grip on illegal FX activities together with other policy risks may take toll on Macau's VIP gaming. Besides, a combination of a strong MOP, global economic slowdown and lingering trade tension could continue to weigh on the tourism and gaming sector. Furthermore, private investment may still have some room to drop as only a few mega projects are under construction. On a positive note, given dovish central banks, China's stimulus, the easing trade tension and the resilient government spending and investment, we see low risk of Macau's economy entering into recession this year. In conclusion, we hold onto our view that Macau's GDP growth will fall in the range of 2%-3% in 2019.
▪ Macau's visitor arrivals grew at the strongest pace since June 2010 by 24.9% yoy in January 2019. ▪ Gross gaming revenue rebounded by 4.4% yoy to MOP25.4 billion in February as the abated seasonality failed. However, the implementation of the new tobacco control law and China's tightened grip on illegal FX activities may continue to loom over the gaming sector.	▪ Same-day visitors grew by 41.8% yoy with the share of same-day visitors in total visitor arrivals rising to 52.1% (highest since February 2018). During the same month, visitor arrivals by land surged by 60.3% yoy. Besides, visitors from Mainland China and HK rose by 29.9% yoy and 21.7% yoy respectively. This indicates that the tourism sector continued to benefit from the infrastructure improvement. Moving ahead, visitor arrivals may continue to grow. ▪ Though total visitor arrivals increased significantly, the average length of stay dropped by 0.1 day yoy to 1.2 days. Besides, the per-capita spending of visitors dropped for the first time since 2Q 2016 by 11% yoy. Zooming in, the per-capita spending of Mainland visitors and HK visitors fell by 13.5% yoy and 2.4% yoy respectively in 4Q 2018. As a result, the retail sales growth decelerated to the softest since 3Q 2016 at 4.1% yoy in 4Q 2018. The dales of luxury goods advanced by 1% yoy in 4Q 2018, the weakest growth since 3Q 2016 while the sales of adults' clothing dropped for the first time since 2Q 2017. Against the backdrop

	of strong MOP, global economic slowdown and lingering trade tension, we are concerned that the infrastructure improvement only brings low-end tourists to the gambling hub and does little to help either the retail sector or the gaming sector. We expect gross gaming revenue to expand by 2%-5% in 2019.

RMB	
Facts	**OCBC Opinions**
▪ RMB broke 6.70 handle initially in the early part of last week driving up the RMB index to above 95. However, RMB gave up most of gains on Friday after dollar rebounded in the global stage.	▪ Given currency policy is usually not the focus of National People's Congress, we expect RMB to continue to consolidate in the current range pending on further catalysts such as dollar movement, trade talk or US-China rate differential.

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