Highlights

The first below 50 reading for China's official PMI since July 2016 confirmed that China is facing heightening downside risk amid the uncertainty from the US-China trade war. As China's top policy makers have increasingly reckoned the downside risk and vowed more counter cyclical measures to support the growth, China has stepped up its policy supports since the beginning of 2019. The PBoC first unveiled the plan to expand the criteria to be qualified for targeted RRR cut for inclusive finance on 2 Jan (expect about CNY300-400 billion liquidity injection) and then announced the first universal RRR cut since April 2016 by 100bps on 4 Jan. Both measures together with the recent establishment of new TMLF facility are expected to net inject CNY800 billion liquidity into the banking system. In the near term, it will help smooth the funding volatility ahead of Chinese New Year holiday season. In the longer term, providing cheap and long term stable funding is the first step to re-shore up banks' confidence to lend out.

The current universal RRR cut has sent much clearer signal that China is able to run full steam to stimulate the economy if needed. This may be positive for the risk sentiment. The RRR cut will also provide liquidity support to the possible increasing issuance of local government debt in the first quarter. China's National People's Congress passed a bill on 29 Dec 2018 to allow local governments issue the debt earlier before the National People's Congress endorses the official quota for 2019 in March. With PBoC has rolled out more stimulus measures, the focus will switch to fiscal policy, which is expected to take a lead in 2019 to stimulate the economy.

On property side, it was reported that China's top four banks in tier one cities such as Shanghai and Shenzhen started to lower mortgage rates for the first time home buyers. It shows that China has turned more flexible on property tightening measures.

Shell's Zhejiang based subsidiary has received a license to trade refined oil products in China's wholesale market. This is the first time for a wholly owned foreign entity to enter China's wholesale refined oil market. China's commitment to more foreign access may set the tone for the upcoming US-China trade talk. China's trade representatives will meet their US counterparties in Beijing for talks on Monday and Tuesday. Nevertheless, the geopolitical risk in East Asia heightened after Taiwanese President Tsai Ing-wen said that Taiwan has never accepted 1992 consensus and Taiwan will not accept "one country two system" in reaction to President Xi's speech last week to commemorate the 40th anniversary of issuing message to compatriots in Taiwan. The Taiwan straits situation could be one of the key focuses in 2019.

In **Hong Kong,** the economic data for last November pained a mixed picture. Loans for use in HK (excluding trade finance) rebounded by 6.9% yoy, probably due to the slightly recovered business sentiments on speculation of US-China trade truce and the retracement of local borrowing costs (HIBOR) during November 2018. However, despite the temporary trade truce, the uncertainties about the trade war development continue to linger. This together with the tightening global liquidity and global economic slowdown indicates that any recovery in business sentiments would be unsustainable. Also, local consumption and visitor expenditure may take a hit. As such, we expect the growth of local loans and retail sales (1.4% yoy in November 2018, the weakest since June 2017) to slow down in the near term. On the HKD liquidity front, 1M HIBOR and 3M HIBOR respectively dropped over 50bps and 30bps to 1.83% and 2.09% after year-end. 1M HIBOR may even fall towards 1.5% in the coming sessions. In the near term, should USDHKD spot touch 7.85 and trigger further liquidity drainage by the HKMA, this may add onto seasonality in capping the downside for the HIBORs. Therefore, we see low probability of 1M HIBOR falling below 1%. Though the interbank funding costs dropped, HKD loan-to-deposit ratio and the share of HKD fixed deposits in total HKD deposits rose to 86.2% and 40.2% respectively in November 2018, both reaching the highest levels since 2011. This points out that smaller banks are facing higher funding pressure amid their relatively heavy reliance on fixed deposits. As such, though the banking system refrained from another prime rate hike in December 2018 and the Fed may slow down the rate hike pace this year, we still expect to see a total increase of about 25bps in prime rate during 2019.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ PBoC announced to cut reserve requirement ratio (RRR) for all banks in two stages in January by 100bps. This is the fifth RRR cut since 2018 and the first universal RRR cut since April 2016. ▪ However, PBoC announced that it will not roll over the maturing medium-term lending facility (MLF) in the first quarter of 2019 as a result of RRR cut. ▪ The RRR is expected to unlock CNY1.5 trillion liquidity. After taking CNY1.2 trillion maturing MLF	▪ The latest RRR cut will mainly serve two purposes. First, in the near term, it will help contain the money market volatility ahead of Chinese New Year holiday and support the holiday funding demand. The 50bps cut on 15 January will match the date for reserve payment while the other 50bps cut on 25 January will match both reserve payment and tax payment. We expect the RRR cut together with the TMLF and expansion of qualified criteria for targeted RRR cut for inclusive finance will total inject about CNY2 trillion ahead of the Chinese New Year holiday. This

in the first quarter into account, the RRR cut will net inject CNY300 billion. ▪ Meanwhile, together with the establishment of targeted medium term lending facility in December 2018 and the expansion of qualified criteria for targeted RRR cut, PBoC estimates to net inject CNY800 billion liquidity into the system. ▪ The RRR cut is expected to save CNY20 billion borrowing costs for banks.	size is similar to CNY2 trillion liquidity injection in 2018 via the 30-day temporary facility contingent reserve allowance (CRA). ▪ Second, in the longer run, the universal RRR cut will provide cheaper and more stable long-term funding as compared to MLF and other open market operation tools. This may give banks more incentives to channel the money to the real economy, which is in line with China's initiative to support the funding demand from the small and private economies. ▪ Since 2018, China has cut the RRR in a targeted way for four times. However, the marginal impact of targeted RRR cut has diminished significantly as China has refrained from a full-scale easing due to concerns that it may dampen its effort on de-leverage campaign. Nevertheless, as the Chinese economy has decelerated recently amid the uncertainty from the US-China trade war, the latest universal RRR cut sent two important signals. First, China reckoned that the downside risk of growth. Second, different from past two years that PBoC only use temporary tools to support holiday funding demand (TLF in 2017 and CRA in 2018), the current universal RRR cut has sent much clearer signal that China is able to run full steam to stimulate the economy if needed. ▪ Clearly, China has further stepped up its policy support in the beginning of the new year. However, whether the easing money will be eventually channelled to the real economy remains to be seen as it will depend on the banks' risk appetite. Nevertheless, providing cheap and long term stable funding is the first step to re-shore up banks' confidence to lend out. ▪ Looking ahead, we expect China to cut RRR further in 2019 by at least another 150bps for two reasons. First, China's RRR for larger banks will stand at 13.5% after the latest 100bps RRR cut. This ratio remains high in any standard. Second, as of end of 2018, the outstanding of MLF was at CNY4.9 trillion with CNY3.7 trillion maturing in 2Q, 3Q and 4Q. There is ample room for China to further cut RRR to replace the MLF to lower the borrowing costs to incentivize banks to lend further. ▪ Last but not least, although the heightening expectation the Fed rate hike pause has capped the upside for USD, the heightening expectation on further monetary easing in China may keep RMB depreciation pressure alive. China has made two good bets on the Fed in the past month. First, China cut the TMLF rate ahead of Dec FOMC meeting and cut the RRR ahead of Fed Chairman Powell speech on the same day. Both bets pay off for now. However, we think the near-term pressure for RMB remains for two reasons. First, market may have underestimated the Fed rate hike probability. Second, China is expected to roll out more easing this year, which may further weigh down on the currency prospect.
▪ PBoC announced on 2nd January that it will expand the criteria for loans to small and micro companies to be qualified for previous targeted reserve requirement ratio (RRR). ▪ Loans to companies with credit line less than CNY10 millions will be qualified for targeted RRR cut, up from previous credit line of less than CNY5 millions.	▪ The expansion of coverage is expected to unlock more long-term liquidity to support the funding demands from small and micro companies. Meanwhile, it will also partially help smooth the volatility in the money market ahead of Chinese New Year holiday season.
▪ China's National People's Congress passed a bill on 29 Dec 2018 to allow local governments issue the debt earlier before the National People's Congress	▪ Historically, the issuance of local government bond is slow in January and February before the NPC officially approved the quota in March meeting. Given the Chinese economy has

endorses the official quota for 2019 in March.	decelerated recently, the grant of partial quota earlier ahead of the March meeting is helpful for local governments to support the growth under the framework of proactive fiscal policy.
▪ Chinese President Xi's speech to commemorate the 40th anniversary of issuing message to compatriots in Taiwan failed to receive the warm reply from Taiwan side. ▪ Taiwanese President Tsai Ing-wen said that Taiwan has never accepted 1992 consensus and Taiwan will not accept "one country two system".	▪ The landslide comeback of KMT in local election in November has eased the tension between mainland China and Taiwan. However, the recent reply from Tsai administration to Xi's proposal may put the cross straits relationship under the spot light again. It is likely to remain one of the geopolitical risks in the region for the next two years.
▪ It was reported that China's top four banks in tier one cities such as Shanghai and Shenzhen started to lower mortgage rates for the first time home buyers.	▪ Together with the news that some cities started to unwind some of property tightening measures, it shows that China has turned more flexible on property tightening measures to counter the impact of external uncertainties on the domestic economy.
▪ Shell's Zhejiang based subsidiary has received a license to trade refined oil products in China's wholesale market.	▪ This is the first time for a wholly owned foreign entity to enter China's wholesale refined oil market. It shows that China is on track to allow more foreign access to its domestic market.
▪ 1M HIBOR and 3M HIBOR respectively dropped over 50bps and 30bps to 1.83% and 2.09% as HKD liquidity turned flushed after year-end.	▪ We expect HIBORs to retrace lower before rebounding on Lunar New Year effect. 1M HIBOR may even fall towards 1.5% in the coming sessions. In the near term, should USDHKD spot touch 7.85 and trigger further liquidity drainage by the HKMA (the first time since last August), this may add onto seasonality in capping the downside for the HIBORs. Therefore, we see low probability of 1M HIBOR falling below 1%. In the short to medium term, given the relatively dovish tone of the Fed and the cautiousness of other major central banks, we expect capital outflows from Hong Kong to be orderly and gradual. As such, though we expect HIBOR to move up, the increase in HIBOR would also be moderate and gradual throughout 2019.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's December PMI fell further to 49.4, below the threshold line of 50 for the first time since July 2016.	▪ Both demand and supply sub-index softened further as a result of rising uncertainty from the trade war. On demand side, new export order slipped further to 46.6 while new order also fell below 50 for the first time since Feb 2016.On supply side, production also started to decelerate in December though it remains in the expansion territory. Meanwhile, finished goods inventory also declined. The falling production together with lower inventory amid weakening demand environment signals the start of de-inventory. This suggest that China's economy may decelerate further in the coming quarters. In addition, the sharp decline of purchasing price implies that China's PPI is likely to stay low in the coming months.
▪ The growth of HK's total loans and advances rebounded from 2% in October to 5.2% yoy in November.	▪ Zooming in, trade finance dropped by 6% yoy as total trade growth fell for the first time since February 2018 by 0.1% yoy on US-China trade war. The growth of loans for use in HK (excluding trade finance) rebounded to 6.9% yoy. This could be attributed to the slightly recovered business sentiments on speculation of US-China trade truce and the retracement of local borrowing costs (HIBOR) in November. Nonetheless, as local interest rates are set to edge up and uncertainties about trade war continues to linger, local loan growth is expected to slow down in the near term. Elsewhere, the growth in loans for use outside of HK moderated further from 6.5% yoy in October to 3.8% yoy in

	November. Mainland companies might have refrained from offshore financing as the rising USD and HKD rates as well as a weaker RMB made financing more expensive overseas than domestically. Lately, onshore financing became more attractive as the PBOC unleashed a raft of accommodative measures. In conclusion, we expect total loans and advances to grow by around 3% in 2018 and see mildly negative growth in 2019 amid high base effect.
▪ Total HKD deposits rebounded by 3.3% yoy in November as growth in HKD fixed deposits remained strong at 22.3% yoy.	▪ Nevertheless, demand and savings deposits slid by 5.6% yoy and 6.9% yoy respectively. As a result, the growth of HKD deposits was slower than that of HKD loans, pushing HKD loan-to-deposit ratio up to the highest since 2011 at 86.2%. Adding on the rising share of HKD fixed deposits (40.2% of total HKD deposits, the highest since December 2011) and the persistently high HKD fixed deposits rates, it points out that smaller banks are facing higher funding pressure given their relatively heavy reliance on fixed deposits. As such, though the banking system refrained from another prime rate hike in December 2018 and the Fed may slow down the rate hike pace this year, we still expect to see a total increase of about 25bps in prime rate during 2019.
▪ HK's RMB deposits remained roughly static at RMB617.5 billion in November.	▪ RMB deposits have remained attractive probably due to two reasons. First, the RMB rallied slightly against the HKD in November thanks to the PBOC's counter-cyclical measures and the increased speculation on US-China trade truce. Second, RMB rates have been relatively higher than USD or HKD rates. In the near term, with the Fed poised to slow down rate hike pace and the PBOC refraining from excessive easing, USD rates may not outpace RMB rates so soon. As such, RMB deposits may remain resilient in the near term. However, in the medium term, should USD-RMB interest rate differential narrow further, RMB deposits would likely retrace lower.
▪ HK's trade activities slowed down notably with imports growth and exports growth decelerating from 13.1% yoy and 14.6% yoy in October to 0.5% yoy and -0.8% yoy in November respectively.	▪ This was in tandem with the slowdown in China's trade activities during the same month and suggests that the trade sector started to feel the pain from US-China trade war. Specifically, the growth of exports to Mainland China softened from 18% yoy in October to 1.0% yoy in November while imports to Mainland China dropped for the first time since March 2018 by 5% yoy. Worse still, external demand appeared to have been weakening as exports to India, Taiwan, Vietnam and Germany (four of the major trading partners) declined by 29.1% yoy, 5.3% yoy, 8.7% yoy and 4.9% yoy respectively. On the other hand, recent retreat in commodity prices and muted domestic demand drove imports from Taiwan, Japan and South Korea down respectively by 14% yoy, 2.5% yoy and 24.7% yoy. Moving ahead, we expect the trade growth to continue moderating. Though the US and China agreed on temporary trade truce, uncertainties about the trade war development continue to linger. Adding on the tightening global liquidity and global economic slowdown, external and internal demand may soften gradually and in turn weigh down the trade growth. More notably, as the US targets at China's high-tech industry, Hong Kong which mainly ships high-tech products would inevitably take a hit should the trade war become a technology war.
▪ HK's retail sales growth decelerated from 6% yoy in October to 1.4% yoy in November, the weakest since June 2017.	▪ Domestically, the sales of goods in supermarkets and consumer durable goods dropped by 0.1% yoy and 2.1% yoy respectively. Local consumer sentiments appeared to have been hurt by two factors. First, wealth effect abated amid housing market and

	stock market corrections. Second, the increasing signs of local economic slowdown clouded wage growth prospects. Externally, the sales of clothing, footwear and allied products as well as those of jewelry, watches and clocks dropped by 2.8% yoy and 3.9% yoy respectively. Though infrastructure improvement brought more tourists to HK with total visitor arrivals growing 20.6% yoy in November, the retail sector barely benefited from this as a relatively strong HKD and the weakening economic outlook of Asia weighed down visitor spending. In conclusion, we total retail sales growth to print around 8% yoy in 2018 and around -2% yoy in 2019.
▪ Macau's gaming revenue increased by 16.6% yoy in December, mainly due to low base effect, year-end holidays and infrastructure improvement.	▪ Despite the rosy performance in December, we expect gaming revenue growth to slow down into 2019 due to several reasons. First, amid the strong MOP and Asia's muted economic outlook, infrastructure improvement may only lure low-end same-day visitors who would contribute little to the gambling hub. Second, tightening financial conditions and China's economic slowdown may hinder the growth of VIP gaming revenue. Third, with mega entertainment projects being completed one by one, the gambling hub can no longer attract tourists with new projects like it did over the past few years. In conclusion, we expect gaming revenue growth will slow down from 14% yoy in 2018 to 2%-5% yoy in 2019.
▪ Macau's visitor arrivals rose significantly by 15.3% yoy to 3.27 million in November with visitor arrivals by land surging by 47.9% yoy, owing to infrastructure improvement linking Macau to Zhuhai and Hong Kong. Overnight visitors and same-day visitors increased respectively by 5.1% yoy and 26.9% yoy. As such, the share of same-day visitors in total visitors increased from 50.9% to 51.3%, the highest level since January 2017.	▪ By source of tourists, total visitors from Mainland China and Hong Kong grew by 15.3% yoy and 25.6% yoy, mainly led by the sharp growth of same-day visitors. This indicates that the Hong Kong-Zhuhai-Macau bridge has brought mainly low-end same-day visitors from Hong Kong and Mainland China to Macau. In this case, the infrastructure improvement may not be able to provide much impetus to the gambling hub. On the other hand, tourists from Taiwan and South Korea continued to decrease by 2.4% yoy and 6.6% yoy respectively while those from Japan merely rose by 0.1% yoy. Taken all together, it suggests that Macau's tourism activities might have lost some traction due to strong MOP and Asia's muted economic outlook. In the near term, the lingering uncertainty about US-China trade war and concerns about further capital outflows from emerging markets may continue to cloud the economic outlook of Asian countries. As such, we expect tourism activities to slow down despite infrastructure improvement.
▪ Macau's unemployment rate decreased further to the lowest level since 2015 at 1.7% during the three months through November.	▪ The labor force remained unchanged at 392900 while the employed population increased slightly to 386100. This indicates that Macau's labor market remains resilient. Specifically, the employed population of construction industry picked up by 2.3% mom amid low base effect. Nevertheless, as most of the mega entertainment projects have opened, construction sector's employment may see limited upside. On the other hand, the employed population of hotels, restaurants and similar activities dropped by 2.1% while that of gaming industry edged down for the third consecutive three-month periods by 0.8% mom. The opening of HK-Zhuhai-Macau bridge has lent some support to Macau's tourism and gaming activities and in turn revived the sectors' hiring sentiments. However, given a strong MOP and Asia's weakening economic outlook, neither tourism nor gaming could see strong growth. As such, we expect to see further slowdown of Macau's economic growth and therefore weaker hiring sentiments across major industries in the medium term.

RMB	
Facts	**OCBC Opinions**
▪ RMB rebounded against the dollar last week as a result of weaker broad dollar due to repricing of Fed rate hike expectation. However, RMB failed to outperform its major trading partners. As such, RMB index softened slightly last week.	▪ Although the heightening expectation the Fed rate hike pause has capped the upside for USD, the heightening expectation on further monetary easing in China may keep RMB depreciation pressure alive. China has made two good bets on the Fed in the past month. First, China cut the TMLF rate ahead of Dec FOMC meeting and cut the RRR ahead of Fed Chairman Powell speech on the same day. Both bets pay off for now. However, we think the near-term pressure for RMB remains for two reasons. First, market may have underestimated the Fed rate hike probability. Second, China is expected to roll out more easing this year, which may further weigh down on the currency prospect.

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