Summary

Last week has been a messy and eventful week for China. Volatility returned to China's money market after almost one and half year smooth ride. PBoC is winning the tug of war to press market participants to curb their excessive leverage in the bond market. Clearly, PBoC is more determined than market previously expected. This makes sense in particular after the Fed rate hike expectation heightened again. A proactive deleverage is better than a passive deleverage forced by higher US rates should Fed hike faster than expected in 2017. Nevertheless, the fact that PBoC has injected liquidity via SLF shows that it is unlikely to rock the boat. As such, we don't expect another round of liquidity squeeze. The ongoing panic in the bond market even after PBoC loosened its grip in the second half of last week shows that investors are re-pricing PBoC's policy stance. The volatility in China's bond market is likely to be one of the key focus this week.

On the positive note, the tight liquidity in the onshore market helped stabilize RMB exchange rate in particular in the offshore market. CNH funding costs spiked again last week with the overnight CNH fixing ended the week at 7.16%. This help bring down the USDCNH from a week high of 6.95 to below 6.88. The talk about capital control was another contributing factor to the recovery of RMB last week. All capital transactions, which exceed US$5 million (including both RMB and foreign currency), need to report to local SAFE. In addition, market talk that China may have launched window guidance on gold imports to curb capital outflows. RMB finally demonstrated its two-way movement against the dollar despite only a mild dollar correction thanks to tighter capital control and liquidity. However, the daily spot trading volume in the onshore market remained high last week, signalling the sentiment remained fragile. Whether the recent measures will finally lead to two-way movement remained to be seen. The increasing volatility in Euro this morning as a result of the failure of Italian referendum may create additional pressure for RMB due to EUR's high weightage in China's RMB basket. The USDCNY is expected to be fixed higher this morning around 6.8860, up from last Friday's 6.8794.

We are seeing an interesting combination of stable RMB and volatile money market, hmmm, this shows to us between currency stability and interest rate stability, currency stability takes the priority for now. This should be the guidance for investors in the coming months. Over the weekend, PBoC senior official Shen Songcheng said that it is the best time to stabilize RMB exchange rate as all the 50K USD individual quota will be refilled from next month.

Growth is not the key focus in the near term as most data released are supportive of stabilizing growth prospect. The relationship between RMB, money market and bond market should still be the key focus ahead of Fed rate hike next week.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ The optimism about the China-US relationship from President Xi Jinping's meeting with former US Secretary of State Henry Kissinger on Friday failed to last more than 24 hours after President elect Donald Trump exchanged a phone call with Taiwan President Tsai.	▪ In reaction to the phone call, China's Foreign Minister Wang Yi blamed Taiwan on the gimmick it played and reiterated that the one-China principle is the foundation for the healthy development of the China-US relationship. ▪ Although the call is unlikely to signal the change of US's policy over Taiwan straits, it is a wake-up call for most Chinese who in favour of Trump that his lack of political experience and an excess of personality may pose uncertainty to the bilateral relationship.
▪ Volatility returned to China's money market after almost one and half year smooth ride. The net withdrawal of liquidity in the beginning of the week by PBoC via open market operation sent the onshore money market rates higher. The liquidity stress eased in the later part of the week after PBoC net injected CNY95 bilion on Wednesday and Thursday via OMO as well as news that some banks tapped PBoC's Standing Lending Facility on Wednesday. ▪ Nevertheless, the sell-off in the onshore market extended to the end of last week despite improving liquidity. The 10 year Chinese government bond yield broke 3%.	▪ It has been a messy week for China's money and bond market. The dust has not settled yet, but we have three takeaways from last week's movement. ▪ First, PBoC is wining the tug of war between regulators and market participants on curbing excessive leverage in China's bond market. PBoC is more determined to correct the excessive leverage. As such, we should prepare for more volatility ahead. ▪ Second, nevertheless, the fact that PBoC has injected liquidity via SLF shows that it is unlikely to rock the boat. As such, we don't expect another round of liquidity squeeze. ▪ The ongoing panic in the bond market even after PBoC loosened its grip in the second half of last week shows that investors have re-priced in PBoC's policy stance. Given PBoC's recent neutral to tight biase, the position adjustment is likely

	to continued in China's bond market.
▪ Shanghai took further step to cool down its property market via increasing the down-payment ratio to 35% for first time buyers. Down-payment for the second purchase will range from 50-70% depending on value and location.	▪ Property price in Shanghai continued to go higher in October despite falling transaction volume after the announcement of tightening measures in early October. ▪ The expand of definition of second home shows that the new rules are tighter than previous measures. This is likely to curb housing demand. We expect the transaction volume to remain sluggish in the coming months.
▪ Both Financial Times and Reuters reported that China may have tightened gold imports.	▪ FT reported that quotas on gold imports have been cut at the quarterly assessment. Since last year, gold has been one of the popular assets sought after as one of the avenue to hedge against the RMB depreciation. ▪ The curb on gold import was considered as additional measures to cap capital outflows by investors. However, this may
▪ The funding costs for CNH spiked last week in the offshore market with overnight HIBOR fixing rose to 7.159% last Friday.	▪ CNH funding costs started to rise in the mid of last week partly due to month-end effect. However, it continued to climb up in the beginning of December. The recent spike of funding costs in the offshore market was mainly attributable to two factors including the spill over effect of tighter onshore liquidity and recent tightening measures in the capital account to curb RMB outflows. ▪ As market is still digesting the news about the latest wave of capital account tightening measures, the CNH Hibor is likely to remain volatile in the coming week. ▪ On the positive note, the tighter offshore liquidity helped ease pressure on CNH spot. The USDCNH spot ended the week at 6.8704 after broke 6.95 in the beginning of the week.
▪ The CSRC chairman Liu Shiyu slammed certain asset managers on their barbaric leveraged company buy-out. He also threatened legal action against those companies.	▪ The comments were believed by market targeting recent acquisition case by insurance companies using insurance funds. The hawkish comments may dampen market sentiment, which may lead to volatility in China's equity market this week.
▪ China's Ministry of Finance plans to issue RMB14 billions of 2-year government bond in Hong Kong this week on 8th December.	▪ It will be a good test on investor sentiment about RMB assets after prolonged RMB depreciation since August 2015.
▪ According to HK Office of the Commissioner of Insurance, the new office premiums from policies issued to Mainland visitors jumped further by 161% yoy to HKD18.8 billion in 3Q, refreshing the record high. Its share in total new office premiums for individual business, however, retreated from 39.3% to 37%.	▪ Insurance in Hong Kong has been one of the key channels for wealthy Chinese to move the money out. However, businesses from Mainland investors may grow at a slower pace in the HK insurance sector in the coming quarters after the new rule effective from 29th October 2016.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's manufacturing PMI expanded further in November to 51.7 from 51.2.	▪ On demand side, both new orders and new export orders increased to 53.2 and 50.3 respectively from 52.8 and 49.2. This suggests the improving demand unaffected by the rising uncertainty following Trump's victory. ▪ On supply side, production index gained another 0.6 to 53.9, highest since July 2014. The difference between new order and finished goods widened to 7.3, highest since March 2011, signalling the room for re-stock. ▪ Clearly, we have seen the return of confidence in the economy

	from both supply and demand sides. ▪ The input prices, however, jumped further to 68.3, highest since March 2011 as a result of rising commodity prices. This implied that producer price index (PPI) is likely to grow by 2.8% yoy in November, up from 1.2% yoy in October. The return of inflationary pressure may further dampen easing expectation.
▪ RMB deposits in Hong Kong shrank by 22.4% yoy for the 14th straight month in October.	▪ On a monthly basis, RMB deposits fell 0.4% to RMB 665 billion as CNH depreciated 1.5% in October against the dollar. The ongoing angst of RMB depreciation could result in a persistent contraction in offshore RMB deposit. In addition, USD deposits skyrocketed 24.6% yoy to HKD 4,229 billion.
▪ Total retail sales in Hong Kong fell for the 20th straight month by 2.9% yoy in October.	▪ The decline has narrowed significantly compared with previous month (-4.1% yoy). We believe that this was due to the reduced drag from the smaller decline in visitor arrivals and the improved market sentiment amid the stable labor market and increasing household incomes. ▪ Decline of visitor arrival narrowed further from 5% to 2.4% in October. Contraction in value of sales of jewellery and watches shrank notably from 12.3% to 0.1% amid improving market sentiment. However, we still need to monitor the retail sales performance closely to judge whether this is a genuine recovery. Meanwhile, consumer durable goods dipped further by 14% yoy. In the near term, outlook for retail sales is still subjected to various external uncertainties, depending on the performance of inbound tourism as well as local consumer sentiments.
▪ Macau's jobless rate stabilized at 1.9% during the three months through October.	▪ However, the employment in different sectors was mixed. Despite improvement in business performance, the retrenchments in the gaming sector may continue and help to further alleviate the labor redundancy. Also, sour hiring sentiment in wholesale and retail sector (-5.1% mom) will likely persist as local and visitor consumption remain to weigh. Besides, employment growth in the Hotels, Restaurants and similar sectors (+0.7% mom) may slow down as increase in labor demand pauses. In all, jobless rate is expected to stay around 2% on tight labor supply. As such, a stable labor market combined with lower inflation may spur consumption. However, this could be constrained by tepid income growth.
▪ Macau's gross gaming revenue (GGR) marked its largest advance since Feb 2014, up by 14.4% yoy to MOP18.79 billion in November amid the lingering effect of low base. The GGR is expected to drop by around 3% this year and resurge by 5% to 7% to above MOP230 billion over 2017 as a whole.	▪ Notably, it is said that junkets resumed credit extension to the premium players while rooms for the high rollers re-opened firstly in two years. Both factors might have brought back some VIP demand. Therefore, continuous expansion in the mass-market coupled with recovery in VIP businesses may fuel a further pickup in the gaming sector. However, the government is poised to tighten regulation on junkets, anti-money laundering and smoking. This is still likely to trim some upward risks on the VIP segment. Also, concern remains that new projects' attractiveness to tourists will diminish in the medium term. Despite that, favourable policies hopefully could lend support to the tourism and gaming sectors. Taken all together, we remain cautiously optimistic about the outlook of the gaming sector.

RMB

Facts	OCBC Opinions
▪ RMB finally broke its depreciation channel after another round of capital control. The USDCNY ended the week at 6.88 after breaking 6.9 last week. This also bring down the USDCNH back to below 6.88 after touching high of 6.95. ▪ RMB index continued to strengthen to 94.91. ▪ PBoC senior official Shen Songcheng said over the weekend that it is the best time to stabilize RMB exchange rate as all the 50K USD individual quota will be refilled from next month.	▪ Since August, RMB has showed pattern of asymmetrical depreciation, meaning RMB weakened when dollar strengthened but failed to gain when dollar retreated. This was mainly due to increasing concerns about one-way depreciation. The recovery of RMB against dollar last week despite a mild correction of dollar index was encouraging. This was mainly attributable to two factors in our view including tighter control on outflows as well as the shift of focus to currency basket anchor. ▪ Despite the recovery of RMB against both dollar and currency basket, daily spot trading volume remained high last week, signalling the sentiment remained fragile. Whether the recent measures will finally lead to two-way movement remained to be seen. ▪ The increasing volatility in Euro this morning as a result of the failure of Italian referendum may create additional pressure for RMB due to EUR's high weightage in China's RMB basket. The USDCNY is expected to be fixed higher this morning around 6.8860, up from last Friday's 6.8794.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Kam Liu
Kamyyliu@ocbcwh.com

Co.Reg.no.:193200032W