**Highlights:**

China's bond market remained under pressure last week as PBoC continued to signal its cautious tone on liquidity that it does not want to keep liquidity too loose in the first half of December via the breakdown of MLF roll over. Unlike past few months when PBoC usually conducted one MLF to cover the entire month's roll over, the PBoC only conducted half last week albeit leaving the door open for additional one in the second half of the month.

In addition, China continued to tighten its financial regulation to enhance its supervision of liquidity risk in the banking sector. The CBRC introduced three new liquidity ratios including the net stable funding ratio (NSFR), the high quality liquid assets adequacy ratio and the liquidity matching ratio in addition to the current liquidity coverage ratio (LCR). The introduction of the high quality liquid assets adequacy ratio is designed to fill the regulatory gap to supervise the liquidity situation of smaller banks with asset size less than CNY200 billion. The recent upgrade of liquidity risk monitor will also encourage banks to go back to its core business such as lending and depositing as part of China's de-leverage campaign. On the positive note, China's financial regulator continued to seek feedback and opinion regarding the major asset management product overhaul, which was unveiled in mid-November. It seems that China may give longer grace period to restructure the wealth management products instead of proposed Jun 2019. This may alleviate the concern on massive unwind and liquidity risk.

China's politburo meeting concluded ahead of China's Central Economic Work Conference that China will speed up housing reform and establish the long term mechanism for housing market in 2018. Market will closely watch the Central Economic Working Conference which is expected to be held from around 14 December.

In Hong Kong, one-month and three-month HIBORs held up well and are expected to hover around their current levels or move slightly higher due to year-end effect and an expected rate hike of the Fed in mid-Dec. Since aggregate balance remains relatively ample at HK$180 billion while there is little sign of capital outflows, we expect HIBOR to subside after year-end. Nevertheless, correction in HIBOR is likely to be capped by several factors. First, the Fed is expected to hike at least three times next year. Second, HKD loan-to-deposit ratio has edged higher notably to an over two-year high of 80.2% in October 2017. Third, any large IPOs could lock up money. As HIBOR is expected to tick up gradually in the coming year, banks may face higher pressure to lift prime rate. November's housing transaction volume has fallen for the fifth consecutive month while October's secondary housing prices index grew at its slowest pace since this January. We expect prospects for higher borrowing costs to suppress not only secondary but also primary housing market. Elsewhere, The Shenzhen Stock Exchange is reportedly in talks on including exchange-traded funds into Shenzhen-Hong Kong Connect. This is expected to attract more Mainland investors, who show increasing needs to diversify their portfolio, to tap HK market and enhance HK's role as the largest offshore Renminbi center.

<table>
<tr><th colspan="2">Key Events and Market Talk</th></tr>
<tr><th>Facts</th><th>OCBC Opinions</th></tr>
<tr><td>▪ The IMF concluded its financial sector stability assessment with China recently and published its stress test results as well as recommendation.<br>▪ The IMF reckoned China's financial risk has accumulated due to rapid increase of financial assets as well as increasingly complex products.<br>▪ IMF also suggested a gradual and targeted increase in bank capital as the capital shortfall in the worst case scenario could account for 2.5% of GDP.<br>▪ Nevertheless, the PBoC countered IMF's warning and said that the tier-one capital ratio for banks accounting for 65% of total bank assets will remain above 7% even in the worst case scenario.</td><td>▪ The debate about China's financial stability is not new. The rapid development of off-balance sheet financing as well as recent rapid increase of off-balance sheet wealth management products to meet retail investors' demand for high yield product with the mentality of implicit guarantee has created massive concerns about credit risks in China.<br>▪ We agree with IMF's concern about China's increasing credit intensity meaning more credit growth needed across the time to generate additional GDP growth. This was mainly attributable to zombie companies as well as implicit guarantee which distorted credit risk. This is the area we believe China will focus on in the next few years. In fact, the latest drafted rule about asset management product was designed to eventually break the implicit guarantee.<br>▪ Nevertheless, we still see low risk of imminent debt crisis in China as more than half of China's corporate debt was owed by SOEs, which will give China more room to manoeuvre.</td></tr>
<tr><td>▪ China's financial regulator continued to seek feedback and opinion regarding the major asset management product overhaul, which was unveiled in mid-November.</td><td>▪ The latest asset management rules have added more uncertainty into China's financial market in particular in the bond market. Credit spread widened due to concerns that banks may have to unwind some credit bond due to concerns</td></tr>
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| ▪ Market players have pleaded for a longer grace period which was initially set at one and half year. | about weaker demand from wealth management products for high yield bonds.<br>▪ One of the key challenges under the proposed asset management rule is the tenor mismatch between underlying assets of wealth management products and liabilities. Under the current product structure, wealth management product, which tend to have shorter tenor with less than 1-year, will be rolled over a few times to match the underlying assets with average duration of 3-4 four years. Should the new asset management rule start in July 2019 as proposed by PBoC, the risk that banks are not able to find liability to match underlying assets will increase, which may lead to market volatility.<br>▪ As such, the latest talk is that the regulator may give a longer grace period for banks to prepare for the change of regulation. |
| ▪ China's banking regulator unveiled the drafted rules to enhance the supervision of liquidity risk in the banking sector. | ▪ The CBRC introduced three new liquidity ratios including the net stable funding ratio (NSFR), the high quality liquid assets adequacy ratio and the liquidity matching ratio in addition to the current liquidity coverage ratio (LCR).<br>▪ The addition of the NSFR shows China will continue to comply with the BASEL III rules. However, it will be applied to big banks with asset size more than CNY200 billion.<br>▪ As smaller banks with asset size less than CNY200 billion are not subject to LCR and NSFR. The introduction of the high quality liquid assets adequacy ratio is designed to fill the regulatory gap.<br>▪ Meanwhile, the liquidity matching ratio will be applied to all lenders regardless of size. Via forcing banks to match their assets and liabilities in maturity, the new ratio will help curb China's financial leverage behaviour by banks.<br>▪ The rapid development of China's financial market in the past few years has led to increasing complexity in China's financial products and funding structure. This may lead to potential credit risk without proper supervision. The recent upgrade of liquidity risk monitor will help China step up supervision. It will also encourage banks to go back to its core business such as lending and depositing. |
| ▪ China's politburo meeting concluded ahead of China's Central Economic Work Conference that China will speed up housing reform and establish the long term mechanism for housing market in 2018. | ▪ This is line with President Xi's points that housing is built to be inhabited not for speculation. We think China is probably ready to use tax tool to curb the speculation. In addition, China may continue to increase supply of economic housing and rental housing to support low income families. |
| ▪ China's central bank conducted less than expected 1-year MLF last week to roll over CNY188 billion MLF matured on 6 Dec. | ▪ Although the PBoC hinted that it is likely to conduct one more MLF on 16 Dec to roll over the matured MLF, the breakdown of MLF operation was still read by market as cautious signal that PBoC does not want to keep liquidity too loose in the first half of December. The next round of liquidity injection will probably depend on the fiscal injection as well as the impact of the December FOMC. |
| ▪ One-month and three-month HIBORs held up well and are expected to hover around their current levels or move slightly higher due to year-end effect and an expected rate hike of the Fed in mid-Dec. | ▪ Since aggregate balance remains relatively ample at HK$180 billion while there is little sign of capital outflows, we expect HIBOR to subside slightly after year-end. Nevertheless, correction in HIBOR is likely to be capped by several factors. First, the Fed is expected to hike at least three times next year while other major central banks may follow suit gradually. Second, HKD loan-to-deposit ratio has edged higher notably to an over two-year high of 80.2% in October 2017, due to strong |

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| | loan demand of local and Mainland companies. This reveals heightened risk of tighter liquidity. Third, any large IPOs could lock up money and limit the downside of HIBOR. As HIBOR is expected to tick up gradually in the coming year, banks may face higher pressure to lift the prime rate. |
| ▪ Several Mainland companies are planning to seek a listing in HK next year. These companies include (1) WeDoctor Group, the Chinese online health care services firm backed by Tencent Holdings, and (2) Xiaomi, Chinese well-known mobile phone manufacturer. | ▪ It is possible that IPOs of China's big names in HK will see positive response and in turn lock up huge amount of money in the market. Therefore, we do not rule out the possibility that large IPOs will temporarily result in a tight liquidity condition and push up HIBOR in the coming year. This is also the reason why we believe that HIBOR is unlikely to retreat to its recent trough. For example, one-month HIBOR is not expected to fall to a level below 0.7% in the coming year. |
| ▪ It is reported that the Shenzhen Stock Exchange is in talks on including exchange-traded funds into the Hong Kong and Shenzhen Connect. The exchange will establish a cross-border fund service platform to better serve Chinese companies. | ▪ After the launch of Shanghai-Hong Kong stock connect and Shenzhen-Hong Kong stock connect, HK's equity market has lured a large amount of capital inflows from China. Chinese investors with increasing needs to diversify their portfolio have actively participated in HK's stock market and even pushed Hang Seng Index up to its highest level since 2007 in late November. Specifically, total southbound flows under the two stock connects amounted to a record high of RMB70.18 billion in November. Given the robust performance of HK stock market, net inflows to HK via the Mutual Recognition of Fund scheme also amounted to RMB12.2 billion as at the end of September. Based on this, we expect the launch of ETF connect to attract more Mainland investors to tap the offshore market. This will also help to enhance Hong Kong's role as the largest offshore Renminbi center. Moving forward, we expect more cross-border investment schemes to be launched as China's authorities are planning for further openness of China's financial market. |

| Key Economic News | |
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| **Facts** | **OCBC Opinions** |
| ▪ China's FX reserve extended its gain for the 10th consecutive month in November to US$3.11928 trillion, up from US$3.10921 trillion in November. | ▪ However, FX reserve fell in SDR term. This suggests that the increase of FX reserve in November was mainly the result of valuation effect due to depreciation of US dollar and capital appreciation.<br>▪ We think the capital flow picture probably remained largely balanced. The balanced flow may sustain as long as the US dollar continue to be trapped in the current range. |
| ▪ China's November trade data surprised the market on the upside with both export and import growth accelerated to 12.3% yoy and 17.7% yoy respectively.<br>▪ As a result of stronger than expected exports, China's trade surplus widened to US$40.2 billion from US$38 billion in October. | ▪ The external demand improved on a broad base. Exports growth to ASEAN jumped to 20.2% yoy in November, up from 10.1% yoy in October. In addition, exports growth to EU and US improved to 14% yoy and 15.2% yoy respectively while exports growth to Japan also recovered to 9.8% yoy.<br>▪ China's demand for commodity remained robust in November. Imports of crude oil rose by 36.7% yoy in value term and 14.5% yoy in volume term. Imports of electronic integrated circuit accelerated to 25.9% yoy, highest since April 2013. This suggested that global business cycle continued to expand. |
| ▪ China's CPI softened slightly to 1.7% yoy in November, down from 1.9% yoy in October while China's PPI decelerated significantly to 5.8% yoy | ▪ On sequential base, CPI growth remained flat in November. The increasing service fee in healthcare was offset by the declining food prices, which fell by 0.5% mom. Given food |

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| from high of 6.9%. | price is expected to rise on seasonal demand, the CPI is expected to remain the current level in December.<br>▪ PPI continued expand by 0.5% on month-on-month basis due to higher raw material prices partly affected by environmental protection measures. The retreat of PPI on year-on-year basis was mainly attributable to fading low base effect. We expect PPI to fall further to below 5% in December due to base effect.<br>▪ The passthrough of higher PPI to CPI remained weak as the higher PPI was driven by supply side factor. We think this weak passthrough may persist in 2018. |
| ▪ HK: October's approved new residential mortgage dropped for the second consecutive month by 15.2% yoy (-1.6% mom). During the same month, growth in secondary housing prices index decelerated to its lowest level since this January and printed 12.5% yoy. Furthermore, housing transaction volume fell for the fifth consecutive month by 16% yoy to 5694 deals in November 2017. | ▪ Despite that, one piece of residential land was sold at a record high price in Nov 2017 while the selling price of some new home projects broke Asia's record in the aftermath. Investor sentiment seems to have rebounded since the new government refrained from carrying out more cooling measures. Also, wealth effect from the bullish local stock market has continued to bolster investment demand.<br>▪ Nevertheless, we note that oversubscription of new home project reduced to about 5 times recently from over 25 times in the first three quarters of 2017. The increased selling prices of new homes have become less acceptable to prospective homebuyers. Moving forward, should global monetary tightening lead HK banks to lift prime rate and result in HK stock market correction, housing demand may take a hit. Therefore, we expect housing transactions to remain muted in the coming year. Secondary home prices index is expected to increase by about 10% in 2017 and grow by 0%-3% in 2018. |

| RMB | |
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| **Facts** | **OCBC Opinions** |
| ▪ RMB weakened against the dollar last week with the USDCNY ended the weak above 6.62 due to broad dollar strength in the global market. Nevertheless, RMB index rebounded slightly as pace of depreciation is still well contained. | ▪ RMB fixing was largely in line with market expectation last week. RMB may find some supports from China's stronger than expected export data. With China continued to work on financial de-leverage, it seems that RMB is unlikely to be back to the spotlight by end of the year. As such, we expect the range of 6.5-6.7 for USDCNY still holds for rest of the year. |

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