Highlights:

Despite upbeat trade data, the Chinese economy cooled further in November with both industrial production and private investment decelerated slightly. This reinforced our view that the Chinese economy is expected to slow down further in 4Q. However, on the positive note, the economic structure improved further. Total fixed asset investment in high-tech manufacturing grew by 15.9% yoy in the first eleven months while output of high-tech manufacturing also expanded at the double digit pace.

The shoes finally dropped and the PBoC followed the Fed rate hike to raise its key money market rates including reverse repo rate, SLF rate and MLF rate by 5bps on 14 Dec. Even though RMB risk is no longer the key concern for now, the interest rate differential is still an important parameter to China's policy makers. Should China decide to keep interest rate differential wide enough to prevent from capital outflows, China may continue to adjust its money market rate upward in 2018. Nevertheless, we think the probability of benchmark interest rate hike is low as high debt level is still the key hurdle in our view.

On the positive note, PBoC tried hard to alleviate the impact of money market rate hike on the market sentiment. PBoC injected more than expected 1-year MLF on the same day when they raised the money market rate. Meanwhile, PBoC also announced revised rules on automatic pledge financing, effective from 29 Jan 2018. By expanding the qualified collateral and maximum of financing, it will help stabilize liquidity. Meanwhile, the use of SLF rate as the benchmark for pledge financing will also help further develop China's interest rate corridor, which defines the SLF rate as the upper band of the corridor. China's Central Economic Work Conference will start from today.

In Hong Kong, all eyes were on whether banking system will lift prime rate following the Fed's fifth rate hike since Dec 2015. However, large banks with flush capital are not in a hurry to raise rates while small to medium size banks also refrain from taking the first step amid fierce competition. Therefore, all banks chose to stay put once again. This sparks market expectation that HIBOR will come off after banks finish window dressing their balance sheets at year end. Nevertheless, we still believe that HIBOR will rise gradually after a brief correction (like one-month HIBOR subsides to around 0.8%) in the beginning of next year due to Fed's rate hike expectations, high HKD loan-to-deposit ratio and potential large IPOs. This also means that HKD deposit rates are more likely to see upward risks than to face downward pressures in the coming year. If this is the case, higher cost of fund may compress banks' net interest margin and add more pressure on banks to lift prime rate next year. As such, even if Mainland investors continue to support HK luxury property market, secondary housing market as a whole will probably take a hit due to higher borrowing costs, increasing public and private housing supply and cooling measures.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ The PBoC raised its reserve repo rate and medium term lending facility (MLF) rate by 5bps in today's open market operation, third money market rate hike since early 2017. ▪ The magnitude of rate hike was halved to 5bps. Meanwhile, PBoC also injected more than expected liquidity via MLF.	▪ The bigger amount of injection coupled with higher interest rates shows that the PBoC wants to send a balance signal. Meanwhile, the compromised 5bps rate hike also shows that China is less concerned about its currency value as compared to early 2017. ▪ We think China may continue to adjust its money market rate in 2018. But we don't expect China to hike its benchmark rate as the high debt level remains the key hurdle. ▪ Impact on bond and currency market is likely to be limited for now.
▪ PBoC announced revised rules on automatic pledge financing. The new rule will take effect from 29 Jan 2018. ▪ There are three notable changes under the new rule. First, amount of financing will be increased. For example, the maximum amount of pledge financing will be doubled to 4% of previous year's paid in capital for policy banks and big banks. Second, the lending rate will be pegged to SLF rate. Third, the scope of qualified collateral will also be expanded.	▪ The automatic pledge financing will allow lenders to borrow from the central bank using bonds as collateral should the lenders have depleted their reserve temporarily. The system is designed to support settlement efficiency and safeguard settlement security. ▪ By expanding the qualified collateral and maximum of financing, it will help stabilize liquidity. Meanwhile, the use of SLF rate as the benchmark for pledge financing will also help further develop China's interest rate corridor, which defines the SLF rate as the upper band of the corridor. ▪ To conclude, we think the new revised rule of automatic

	pledge financing is expected to keep money market volatility in check.
▪ HKMA raised base rate by 25 bps right after Fed rate hike on Dec 14.	▪ This is in line with expectations. Though Hong Kong has followed the Fed and raised rates for five times since Dec 2015, banking system refrained from lifting prime rate. This time, banks still stayed put as liquidity remains relatively flushed. Aggregate balance amounted to HK$179.679 billion as at Dec 13, which is well above its historical average. Meanwhile, we continue to see southbound equity inflows under two stock connects. Therefore, larger banks with ample liquidity may not rush to raise rates while small to medium size banks, which suffered more from higher cost of fund, may also refrain from taking the first step amid fierce competition. ▪ Nevertheless, as HIBOR is expected to remain on uptrend in the coming year, mortgage loan rates will continue to top their cap. Adding on an expected uptrend of deposit rates over 2018, higher cost of fund may further compress banks' net interest margin. In this case, banks will face more pressure to lift prime rate next year. The need to hike could be more imminent should inflationary pressure intensify and trigger the tipping point of global liquidity some time in 2018.
▪ HK banks successively raised HKD deposit rates. One-year HKD deposit rate caught up with one-year HIBOR and is set as high as 1.5%.	▪ There are several factors driving banks to increase HKD deposit rates. First, banks have been striving to boost deposits in an effort to window dress their balance sheets before year end. Second, banks might have been hoarding cash in order to prepare for capital outflow risks which may stem from further rate hikes by the Fed next year. Market speculates that Trump's tax reform could prompt the Fed to raise rates more than three times in 2018 after a 25bps hike in this December. Third, robust loan demand propels banks to push up deposits. Resilient domestic growth has supported local loan demand while tight liquidity in Mainland China has shifted onshore funding needs to the offshore market. As a result, HKD loan-to-deposit ratio rose to 80.2% in November, its highest level since 2015. Though we expect HIBOR to subside a bit on the still flush liquidity after year-end effect abates, it is still likely to tick up gradually over 2018 given Fed's rate hike expectations, high HKD loan-to-deposit ratio and potential large IPOs. Therefore, we also believe that HKD deposit rates are more likely to see upward risks than to face downward pressures in the coming year.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's key economic indicators in November was in line with market expectation. ▪ Fixed asset investment grew by 7.2% yoy in the first eleven months, intact from that in the first ten months. ▪ Industrial production decelerated slightly to 6.1% yoy in November from 6.2% yoy in October. ▪ Retail sales reaccelerated to 10.2% yoy in November.	▪ The stabilization of fixed asset investment was mainly attributable to strong infrastructure investment, which grew by 20.1% yoy in the first eleven months, up from 19.6% yoy. ▪ Investment in manufacturing sector remained stable, however structure of manufacturing investment improved as more money was channelled into high tech manufacturing sector, which grew by 15.9% yoy in the first eleven months, way above 4.1% yoy growth rate of investment in overall manufacturing sector. ▪ Industrial production data showed the similar trend that China is moving up the value chain. Although headline industrial production slowed slightly as the decline of mining output

	widened again, output of high tech manufacturing such as computer and communication equipment as well as pharmaceutical grew at the double digit pace. ▪ China's consumer confidence remained upbeat. The rebound of retail sales in November was also partially attributable to the double eleven sales.
▪ China's net foreign exchange purchase reported by PBoC increased for the third consecutive month by CNY2.37 billion in November.	▪ The small increase shows that China's capital flow was largely balanced in November. As we expect China's currency reform is likely to take a back seat in the near term, the balanced capital flow is likely to persist aided by stable currency outlook.
▪ HK: The number of residential property transaction deals which involved Double Stamp Duty (DSD) and Buyer Stamp Duty (BSD) increased by 7% mom and 5.4% mom to 916 and 483 respectively in November 2017. More notably, the value of BSD for residential property transactions soared by about 90% mom to a one-year high of HK$1.068 billion. This reflects huge increase in the selling prices of some homes.	▪ Since the government sold one piece of residential land at a record high price in Nov 2017, this exerted spill-over effect to the property market. Hang Seng Index closed at its highest level since 2007 in late November. This also intensifies wealth effect and encourages investors to tap the overheated housing market. Furthermore, luxury properties have lured Mainland investors, who have increasing needs to diversify their portfolio. China's resilient growth and loosened policy on overseas investment might continue to support HK's luxury real estate market in the coming year. In comparison, prospects for higher interest rates, increasing public and private home supply and cooling measures together may hit demand for secondary housing market.
▪ Macau's housing transactions rebounded by 33.8% mom to 890 deals in October. Pent-up demand post-typhoon translated into large interests in the new home projects launched since late September. As property developers set relatively high prices for their new projects, average housing prices rose by 17% mom (31.2% yoy) to MOP117,360/ sq. m. in October. However, housing transactions and approved new mortgage loans both slid for the third consecutive month and were down by 12.9% yoy and 2.2% yoy respectively. This indicates that secondary housing market remained suppressed by cooling measures and prospects for higher borrowing costs.	▪ In the near term, new home supply may grow as housing completions surged by 903% yoy to 3970 units during the first ten months of 2017. Given a stable labor market and resilient local economy, demand for new homes is expected to hold up well. As a result, even if higher interest rates and cooling measures continue to damp secondary housing demand, average housing price may still oscillate around its current level in the coming months. ▪ In the longer term, though there will be mounting upward risks on interest rates in the coming year, downside on the housing market could still be limited due to scarce new home supply. Specifically, housing starts fell by 15% yoy to 3092 units during the first ten months of 2017 after decreasing by 6% yoy in 2016. Besides, the government plans to build around 9,500 public housing units in the short-to-medium term, 3,100 fewer than that proposed in 2016. This signals that public housing will also remain in short supply. Therefore, despite higher rates which may weigh down demand, housing market may still be able to grow moderately in the coming years. We will also monitor whether the completion of Hong Kong-Zhuhai-Macau Bridge will bring more housing demand to the gambling hub.

RMB	
Facts	**OCBC Opinions**
▪ RMB remained stable against the dollar as dollar's strength failed to sustain following weaker than expected US core CPI.	▪ As we expect China's currency reform is likely to take a back seat in the near term, the balanced capital flow is likely to persist. We expect the USDCNY to remain in the narrow range for now.

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