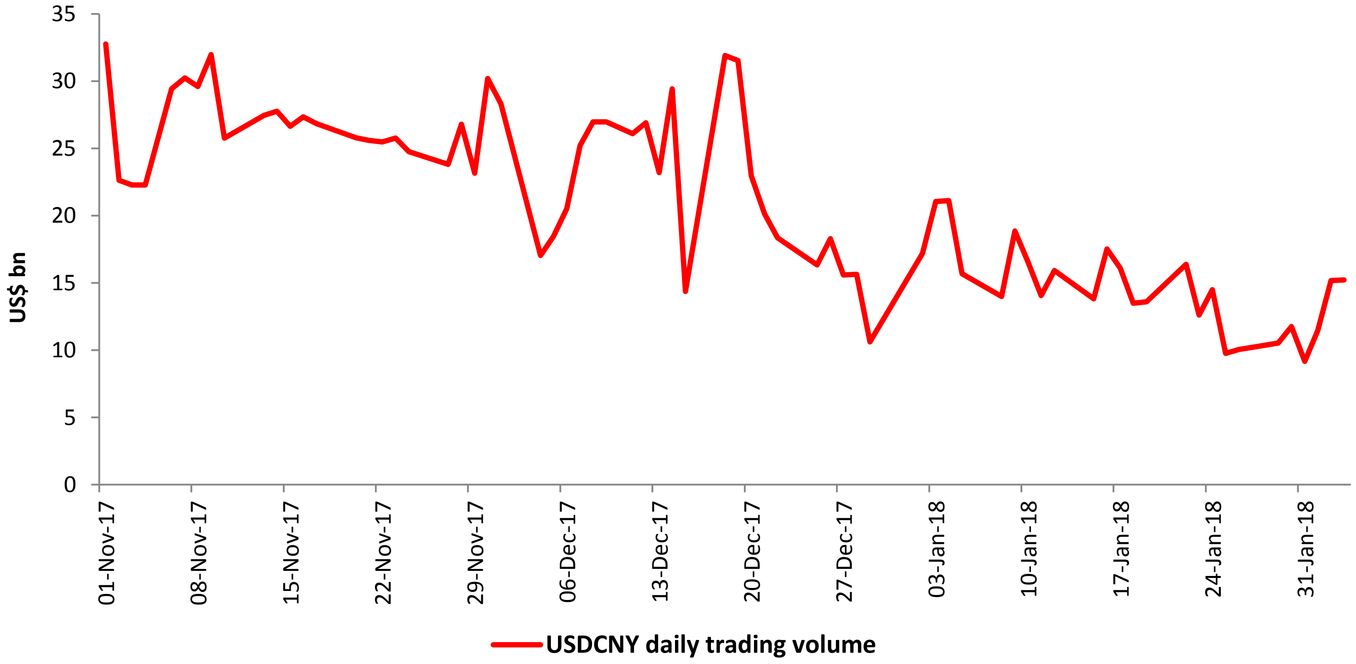
Highlights

RMB remained the key focus last week. RMB's appreciation against its major trading partners accelerated last week with RMB index rose by 0.6% outperforming RMB's gain against the dollar. China has not showed signs of discomfort about the recent RMB appreciation, which may disappoint the exporters who are waiting for the USDCNY to bounce to sell their proceeds. The RMB index broke 96 last Thursday with little resistance though the USDCNY fixing was set at higher than expected 6.3045 on Thursday, which sparked speculation about the revival of counter cyclical factor. However, the Friday's fixing has confirmed that China has not restarted the CCF to slow down the pace of appreciation. The selloff of Korean Won and Japanese Yen last Friday may create more pressures for RMB index to rise at a faster than expected pace. With the RMB index firmly above 96 level, we think this week will be important to monitor the possible reaction from the PBoC.

As RMB depreciation is no longer a concern, China may restart the engine of RMB Internationalization. China re-launched onshore repo facility to offshore bond investors, which was suspended shortly after they first launched in June 2015. We see three possible implications of the repo facility.First, it is positive for building RMB liquidity pool in the offshore market which will help stabilize the CNH funding costs. Second, it may help reboot the development of dim sum bond market due to improving funding costs. Third, it will revive the interests of offshore investors to participate in the onshore bond market. In fact, we have seen significant and persistent inflows from offshore investors to China's onshore bond market in the past years. The repo facility will help reinforce this trend.

In Hong Kong, average repayment to income ratio rose to 35% in Nov 2017. Households' debt burden may grow further should banks begin hiking local interest rates this year. Though household debt to GDP ratio hit its record high at 69.1% in 3Q 2017, it remains relatively low as compared to some developed countries. This means that the systematic risk from the overheated housing market is well contained. On the other hand, total loans and advances exhibited 11 consecutive months of double-digit annual growth in Dec 2017. Strong trading activities, resilient asset markets and positive global economic outlook may continue to support local loan demand in 1H 2018. In addition, a stronger RMB combined with prospects for tight onshore liquidity condition may continue to shift Mainland companies' funding demand to overseas markets. Adding on loans demand associated with the Belt and Road Initiatives, loans for use outside of HK are likely to expand further this year. Nevertheless, total loans growth could slow down somehow amid high base effect. In Macau, gross gaming revenue grew at its strongest pace since Feb 2014 by 36.4% yoy in Jan. Eased concern about tightening regulation on junket operators and improved tourism activities has together supported gaming growth. At this juncture, we hold onto our view that VIP segment will take a backseat amid policy risks and liquidity risks. Instead, mass-market may contribute more to the gaming growth in the longer term, especially given infrastructure improvement and a fresh wave of new hotel and casino openings.

Chart of the week: The USDCNY daily trading volume data is no longer a good indicator as China moved to a new trading system of matching orders for market makers, which is not captured by the current database. However, the rebound of trading volume last Friday may still show that the overshooting risk of RMB cannot be ruled should exporters start to sell dollar.



Source: Bloomberg, OCBC

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China re-launched onshore repo facility to offshore bond investors.	▪ To recap, PBoC announced the launch of bond repo facility in June 2015 to allow offshore RMB clearing banks and participating banks, which have already obtained quota to access to the onshore interbank bond market, to borrow money in the onshore market via repo facility. The borrowed funds are allowed to bring back to the offshore market. The move was initially designed to further support China's capital account liberalization, RMB internationalization as well as attracting more foreign investors to invest in China's onshore bond market. However, the repo facility was unofficially suspended later due to concerns about capital flight following the currency reform in August 2015. ▪ The re-launch of repo facility shows that RMB depreciation and capital flight have been less a concern. And China is ready to re-launch its push for RMB internationalization. We see three possible implications of the repo facility. ▪ First, it is positive for building RMB liquidity pool in the offshore market which will help stabilize the CNH funding costs. Second, it may help reboot the development of dim sum bond market due to improving funding costs. Third, it will revive the interests of offshore investors to participate in the onshore bond market. In fact, we have seen significant and persistent inflows from offshore investors to China's onshore bond market in the past years. The repo facility will help reinforce this trend.
▪ The latest data from China's currency regulator SAFE showed that there is no increase of QFII quota in January. However, the approved RQFII quota increased slightly to CNY610.36 billion from CNY605 billion in 2017.	▪ As China has committed to further open its financial market to foreign investors, we think the quota for both QFII and RQFII will increase gradually this year.
▪ The PBoC suspended its open market operation last week due to relatively flush liquidity thanks to China's temporary contingency reserve arrangement.	▪ The suspension of daily open market operation resulted in net withdrawal of CNY760 billion liquidity, highest since March 2016. This shows PBoC's tight bias.
▪ PBoC deputy Governor Yi Gang reiterated China's prudent monetary policy in his latest article. Meanwhile, he also highlighted that China will continue to improve its macro prudential framework to include shadow banking, property finance and internet finance.	▪ The increasingly tightening financial environment is likely to continue to dominant China's financial market in 2018. The latest correction in equity market last week was also a reflection of concern about the negative impact of financial regulation.
▪ According to the latest Policy Address, HK Chief Executive Carrie Lam proposed to increase 4800 subsidized homes for residents living in public rental flats by end of this year. However, HK Housing Authority declined the proposal, in an effort to avoid lengthening the waiting times of applications for public rental housing.	▪ According to Midland Reality's data, transaction volume of primary public housing totaled only 2315 deals during 2016 and 2017, lower than the new supply of 3017 subsidized units in the same period. This indicates that some households living in public rental flats may not be able to afford a subsidized flat. Therefore, it is reasonable for the Housing Authority to suggest launching such kind of subsidized homes at a slower pace. According to the Housing Authority, it is estimated that new supply of public rental housing will average at 14680 units per year in the coming five years, 17% higher than the average of 12530 units per year during the past five years. As for subsidized flats, the new supply for the coming five years will

	average at 4680 units per year, much more than the average of 603 units in the past five years. All in all, we continue to believe that increasing supply of public housing will help to distract demand for smaller units from private housing market while also add some downward pressure onto private housing rents.
▪ The latest data from the HKMA indicates that the average loan to value ratio of approved new mortgage loans dropped to 49% in November 2017 from the 64% seen before a slew of cooling measures were implemented. Average repayment to income ratio rose to 35% in November 2017. Household debt to GDP ratio reached its record high at 69.1% in 3Q 2017.	▪ Taken all together, it indicates that a slew of cooling measures have helped the banking system reduce risks associated with mortgage loans. However, as housing price growth surpassed wage growth, households' debt burden has been growing. The situation could be even worse should local interest rates start to go up. More notably, given wealth effect from stock market, strong local economy and a tight labor market, mortgage loans with high loan-to-value ratio, which are provided by property developers, have successfully attracted prospective buyers to enter the primary housing market. Such mortgage loans normally refer to prime rate. As we expect the prime rate hike cycle to kick off this year, households' debt burden is likely to increase further in the coming years. On a positive note, household debt to GDP ratio remains relatively low as compared to some developed countries. This means that the systematic risk from the overheated housing market is well contained.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's manufacturing PMI softened slightly to 51.3 in January from 51.6 in December 2017. ▪ Meanwhile, the composite PMI remained unchanged at 54.6.	▪ On demand, both new orders and new export orders moderated noticeably to 52.6 and 49.5 in January from 53.4 and 51.9 respectively. The slip of new export order to below 50, first time since October 2016, implied possible slowdown in China's trade growth. On supply, production also fell slightly to 53.5 from 54, but still well above threshold line. ▪ Purchasing price index moderated further to 59.7 from 62.2. As such, we expect China's PPI to slow down further in January.
▪ Hong Kong total loans and advances increased by 16.1% yoy in December 2017, exhibiting 11 consecutive months of double-digit annual growth. This is attributed to strong trading activities, resilient asset markets and positive economic outlook across the globe. Also, China's tightening liquidity has encouraged Mainland companies to get funding overseas and in turn boosted HK's loan demand.	▪ In terms of loans for use in HK, we note that trade finance steadily increased by 8.7% yoy in December, in line with the growth trend of total exports and imports. Meanwhile, local loans (excluding trade finance) jumped by 16.1% yoy. Property developers aggressively bid for residential lands and actively expanded their business amid robust housing market performance. This in turn translated into higher loan demand with loans to property developers surging 28% yoy. In addition, financial institutions' funding needs increased in order to capture the business opportunities associated with the bull market. Nevertheless, with HIBOR ticking up notably in the last few months of 2017 and the cooling measures continuing to tame secondary housing transactions, approved new mortgage loans dropped for the fourth straight month by 14.4% yoy in December. Moving forward, we expect trade finance to hold up well on the back of benign global growth in the coming year. Still, we will closely monitor potential trade conflicts. On the other hand, the outlook of local loans (excluding trade finance) is less positive as we are wary of global monetary tightening which may lead to stock and housing market correction. With demand for mortgage loans decreasing, banks may scramble to launch attractive mortgage plans and be reluctant to lift lending rates, especially given flush liquidity at this juncture.

	▪ Loans for use outside of HK registered double-digit annual growth for the 11th consecutive month by 17.4% yoy. As liquidity condition is expected to remain relatively tight in the onshore market, Mainland companies may continue to shift funding demand to overseas markets. A weaker USD and HKD against RMB will also boost demand for offshore loans by Chinese names. Adding on loans demand associated with the Belt and Road Initiatives, loans for use outside of HK are likely to expand further this year, albeit at a slower pace amid high base effect. ▪ Finally, RMB deposits (RMB 559.14 billion) saw its first annual growth of 2.3% in more than two years. This is due to a stronger RMB (CNH appreciated nearly 8% against HKD in 2017) and higher CNH deposit rates. As we approach Lunar New Year, tight offshore yuan liquidity may drive CNH deposit rates up further. Adding that risk on the RMB tilts to the upside should greenback remain surpassed, we expect RMB deposits to rebound gradually this year. Also, a stronger RMB may encourage RMB cross-border trade settlement with remittances for such settlement to rally further after advancing 49% yoy in Dec 2017.
▪ Retail sales (+5.8% yoy in December 2017) have increased for ten consecutive months, notching the longest streak of gains since early 2014.	▪ By broad type of retail outlet, sales of clothing, footwear and allied products increased for the fourth straight month by 6% yoy. Sales of luxurious goods (+6.3% yoy) marked six consecutive months of gains. The robust data print could be attributed to improved tourism activities and stronger visitor spending on Asia's resilient economic growth. In December, the number of visitors from Mainland China advanced by 7.2% yoy while total visitor arrivals rose by 4.7% yoy. More notably, sales of durable consumer goods jumped by 12.3% yoy after growing 14.8% yoy in the previous month. This is probably due to low base effect and upbeat local consumer sentiment. ▪ Internally, benign wage growth and wealth effect from stock and housing market together will continue to support local spending. Externally, a weaker HKD, sustained growth of Asia and the expansion of Asia's middle class will likely boost HK tourism and inbound visitor spending. In conclusion, retail sector is poised to gain momentum gradually this year. As such, retail shop rents and prices (+1.6% yoy and +7.2% yoy respectively in November 2017) are likely to edge up moderately especially for shops in prime location. Still, we remain wary of the fierce competition from overseas online shops and the impact of China's loosened import policy.
▪ Macau's gross gaming revenue surprised on the upside and grew at its strongest pace since February 2014 by 36.4% yoy to MOP26.26 billion in January. Eased concern about tightening regulation on junket operators and improved tourism activities has together supported gaming growth.	▪ However, the sustainability of VIP revenue growth remains doubtful. According to the latest policy address, the Government proposes to review the laws and regulations on the gaming industry and increase non-gaming elements. This indicates that policy risk is looming over the VIP segment. Besides, as we expect funding costs to increase gradually, junket operators may be hindered from providing credit extensions for VIP gamblers. Since the risk on VIP segment tilt slightly to the downside, we do not believe that January's robust gaming growth could sustain throughout the year. At this juncture, we hold onto our view that VIP segment will take a backseat while mass-market will contribute more to the gaming growth in the longer term, especially given infrastructure improvement and a fresh wave of new hotel and casino

	openings. For 2018, gaming sector is expected to continue its growth albeit at a slower pace (10%-15%) amid high-base effect.
▪ Macau's hotel occupancy rate increased by 2.8 percentage points on a yearly basis to 92.5% in December 2017, the highest level since records began in 1997 due to Christmas and New Year Holidays. The number of hotel guests climbed by 9.6% yoy in 2017 as a whole on the back of improved tourism.	▪ We note that hotel guests from South Korea and China surged significantly by 13.5% yoy and 64.7% yoy respectively in 2017. However, hotels guests from Hong Kong dropped by 9.6% yoy, probably due to high accommodation and transportation costs. Despite that, we expect the growth momentum of Macau's tourism and hotel sectors to sustain in 2018, given the opening of the slew of new entertainment projects, the completion of Hong Kong–Zhuhai–Macau Bridge, a weaker MOP and sustained growth in Asia.

RMB	
Facts	**OCBC Opinions**
▪ RMB extended its gain against both dollar and its major trading partners last week. The USDCNY briefly broke 6.28 but ended the week around 6.30. RMB index broke the key psychological level of 96 with little resistance.	▪ China has not showed signs of discomfort about the recent RMB appreciation, which may disappoint the exporters who are waiting for the USDCNY to bounce to sell their proceeds. The RMB index broke 96 last Thursday with little resistance though the USDCNY fixing was set at higher than expected 6.3045 on Thursday, which sparked speculation about the revival of counter cyclical factor. However, the Friday's fixing has confirmed that China has not restarted the CCF to slow down the pace of appreciation. ▪ The selloff of Korean Won and Japanese Yen last Friday may create more pressures for RMB index to rise at a faster than expected pace. With the RMB index firmly above 96 level, we think this week will be important to monitor the possible reaction from the PBoC. ▪ Should the PBoC remain quiet, the risk of RMB's overshooting cannot be ruled as the demand from exporters to sell USD ahead of Chinese New Year holiday may keep the pair heavy. The rebound of the USDCNY trading volume on Friday may show some early signs of panic sell from exporters.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Co.Reg.no.:193200032W