Highlights

US President Trump's announcement last Thursday that he would formally announced 25% tariff on steel imports and 10% on aluminium imports from all countries this week ahead of mid-April deadline shocked the global market. As widely pointed out by global media, the direct impact of the tariff on steel and aluminium imports on China is very limited as China only accounted for about 2.2% of US steel imports. The Trump Administration is currently relying on four types of remedy tools to address US's trade deficit with China including the antidumping and countervailing duty investigation, Section 232 of the Trade Expansion Act of 1962, Section 301 and Section 201 of the Trade Act of 1974.

Whether it will escalate to a full blown up trade war between US and China will probably depend on two factors including the result of Section 301 investigation and China's possible reaction. In addition, the US senate passed the new Taiwan Travel Act last week to allow US officials at all levels to travel to Taiwan as well as permit the high level Taiwan officials to enter the US under respectful conditions. The bill has cleared both chambers and President Trump will have 10 days to sign into law. The Trump Administration seems to play Taiwan card again. This may add more uncertainty to already looming US-China trade tension.

We will send a separate report to share our thoughts on the recent US-China trade tension in more details. Please stay tune. In terms of China's reaction, although Liu He came back from his Washington trip with no concrete conclusion, China is likely to recompense injury with kindness to further open its domestic market. Nevertheless, the possibility of retaliation cannot be ruled out. We doubt China will use RMB or US Treasury as weapon. Market should watch more closely on whether China will launch investigation on imports of US soybean, which is one of the top US products to China. Should China start to target soybean, the risk of escalation may heighten.

The tension did not stop at US; Bloomberg reported that the European Union may beef up a plan to screen foreign investments due to China's M&A drive. Although EU might be the victim of Trump Administration's trade tariff, it did not stop them from take a tighter approach to China's overseas expansion which may have triggered some political unease in the bloc. With the rise of nationalism globally, the volatility of globalization is likely to rise further. For the next two weeks, market should observe the development of trade tensions other than China's National People's Congress. We expect market volatility to pick up due to heightening trade tensions.

In **Hong Kong**, USD/HKD surged to 7.8315, the highest level in ten years due to a wide yield differential and concerns about potential trade conflicts. Moving forward, with major central banks to remain cautious about tightening in the near term and southbound equity inflows to continue amid huge demand for portfolio diversification, we do not see much capital outflow risks for HK. Therefore, flush liquidity may persist and keep USD/HKD above 7.82. Concerns about potential trade conflicts also weighed down Asian currencies including the RMB and the HKD. Still, USD/HKD may find resistance around 7.83 as capital outflow risks remain well-contained. Increasing large IPOs following the revamp of IPO rules in 2Q 2018 may also lend short-term support to the HKD. However, in the medium term, should global monetary policy tighten at a faster pace than expected, the resultant capital flight from HK could push USD/HKD towards 7.85. On the other hand, as fiscal surplus for 2017-18 far outweighed the original estimate, the government plans to expand the fiscal stimulus for 2018-19, in order to bolster a more sustainable economic growth in the medium term. Therefore, we expect HK's GDP to sustain growth momentum this year after expanding significantly by 3.8% in 2017. **In Macau**, GDP expanded at its strongest level since 2013 by 9.1% yoy in 2017 after contracting for three consecutive years, supported by broad-based growth in Asia. Economic growth may remain resilient and print about 7% in 2018 as infrastructure improvement, new wave of mega project openings, a weaker MOP and Asia's benign growth outlook will underpin tourism and gaming sectors.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ US President Trump's announcement last Thursday that he would formally announced 25% tariff on steel imports and 10% on aluminium imports from all countries this week ahead of mid-April deadline shocked the global market. Although certain exemptions could be considered for tariff on steel and aluminium imports according to Trump's top trader advisor Peter Navarro, the trade war threat from Trump clearly shows the escalation of global trade tension.	▪ As widely pointed out by global media, the direct impact of the tariff on steel and aluminium imports on China is very limited as China only accounted for about 2.2% of US steel imports. Countries like Canada, Brazil and South Korea are probably more worried than China. However, the tariff on solar cell and washing machine announced in late January following the Section 201 investigation and the latest tariff on steel and aluminium following the Section 232 investigation showed the worrying escalating trend. Whether it will escalate to a full blown up trade war between US and China will probably depend on two factors

	including China's retaliation and the result of Section 301 investigation. ▪ On 18 August 2017, the USTR initiated an investigation on whether China's laws, policies or practices may harm American intellectual property rights, innovation or technology development. The decision will be made within 12 months from the initiation. As such, the deadline for Section 301 will be August 2018. ▪ Section 301 investigation is not really new to China. Since 1990s, the US has launched the Section 301 investigation on China. The latest was in 2010 under Obama Administration targeting at China's green technology, which resulted in WTO dispute. The dispute was solved after China agreed to stop subsidizing program. ▪ As compared to 2010, this round of Section 301 investigation has a much wider impact as it challenges China's "made in China 2025" ambition. ▪ Please see details in our special report on US-China trade tensions.
▪ The US senate passed the new Taiwan Travel Act to allow US officials at all levels to travel to Taiwan as well as permit the high level Taiwan officials to enter the US under respectful conditions. The bill has cleared both chambers and is waiting for President Trump's signature into law.	▪ From China's perspective, the new Travel bill is in violation of "One China" policy. The Trump Administration seems to play Taiwan card again. This may add more uncertainty to already looming US-China trade tension. Trump will have 10 days to sing the Act into law. As such, China's reaction will be important.
▪ The tension did not stop at US; Bloomberg reported that the European Union may beef up a plan to screen foreign investments due to China's M&A drive.	▪ Although EU might be the victim of Trump Administration's trade tariff, it did not stop them from take a tighter approach to China's overseas expansion which may have triggered some political unease in the bloc. With the rise nationalism globally, the volatility of globalization is likely to rise further.
▪ USD/HKD broke its key resistance of 7.83 on last Friday, reaching its highest level in ten years at 7.8315 due to a wide yield differential and concerns about potential trade conflicts.	▪ After Fed's new Chair Powell delivered a rather hawkish speech, market fret that the central bank will raise rates at a faster pace than expected. As a result, 3-month LIBOR topped 2% for the first time since 2008 while the gap between 3-month LIBOR and 3-month HIBOR also widened to a ten-year high of 96 bps. This encourages carry trade activities which sell the low-yielding HKD for high-yielding USD. Therefore, HKD faced larger downward pressure. ▪ In addition, southbound equity outflows under the stock connects for 27 Feb and 28 Feb together reached record high of RMB3.44 billion amid concerns about tighter regulation on China's financial institutions following the third plenary session of the 19th Communist Party of China Central Committee. This also adds downside risks to the HKD. Furthermore, concerns about potential trade conflicts weighed down Asian currencies including the RMB and the HKD. ▪ Moving forward, with major central banks to keep their accommodative monetary policy unchanged in the near term and southbound equity inflows to continue amid huge demand for portfolio diversification. Therefore, flush liquidity may persist and keep USD/HKD above 7.82. Still, USD/HKD may find resistance around 7.83 as capital outflow risks remain well-contained. Increasing large IPOs following the revamp of IPO rules in 2Q 2018 may also lend short-term support to the HKD. ▪ However, in the medium term, should global monetary policy tighten at a faster pace than expected, any capital rotation from emerging market to developed market or from Hong Kong to

	Mainland China could push USD/HKD up towards 7.85.
▪ The Macau branch of Bank of China issued the first Dim Sum Bond in Macau on 26 February 2018. The deal consists of RMB 2.5 billion of three-year notes and RMB 1.5 billion of one-year notes. The yield of the three-year and one-year notes is set at 4.65% and 4.45% respectively. The issuance was nearly two times oversubscribed and is the largest Dim Sum Bond issuance since the PBOC reformed the USD/RMB mid-price fixing mechanism in Aug 2015.	▪ As confidence in RMB has recovered and offshore RMB liquidity improved, the Dim Sum Bond market appeared to have bottomed out despite further opening up of onshore bond market. The re-launch of onshore repo facility to offshore bond investors early this year may also help to improve offshore liquidity. With China's authorities to speed up RMB internationalization this year, we expect the development of offshore yuan market to deepen. On the other hand, China's persistent deleveraging campaign may drive up the yield of RMB asset and supported the demand for such assets.
▪ HK: 2017-18 budget balance came in at a surplus of HK$138 billion (5.2% of GDP), much stronger than a budgeted HK$16.3 billion. This is attributed to robust performance of the stock market and housing market.	▪ We think there are several key takeaways from the budget. First, the government expands one-off relief measures and reduces tax burdens on individuals to support the poor, the students, the elderly, SMEs and the salaried workers. This may be more effective than cash handout to support private consumption. Second, the government largely increases recurrent expenditure on healthcare to tackle the worsening ageing problem. Third, the government strives to increase both private and public housing supply at a faster pace than previously expected. This together with the prospects for higher interest rates may help to calm the over-heated property market. Fourth, the government increases financial support for the pillar industries including financial and tourism sectors while also adds financial support to the innovation and technology sector, in order to diversify the economy. Taken all together, the expanded fiscal stimulus is favorable to a more sustainable economic growth in the medium term. ▪ As total spending is expected to increase by 17.6% yoy while revenue is estimated to drop by 1.3% yoy for the coming fiscal year, Fiscal surplus for the coming year is penciled at HK$46.6 billion with fiscal reserves to print HK$1,138.6 billion by the end of March 2019, representing 40.3% of GDP. ▪ Finally, GDP growth accelerated to 3.8% in 2017 from 2.1% in 2016, the strongest level since 2011. Given stronger private investment, resilient external demand, and the expected improvement in domestic consumption and tourism activities, the government forecasts a GDP growth of 3%-4% for 2018. However, we are wary of potential trade conflicts and capital outflow risks as the former may weigh on exports of goods while the latter could drag down private investment. Adding on high base effect, we expect GDP to expand 2.9% yoy in 2018.

Key Economic News

Facts	OCBC Opinions
▪ China's official PMI fell by more than expected to 50.3 in Feb from 51.3 in January led by sharp decline of small companies' activities.	▪ Although PMI is the seasonal adjusted data, the impact of Chinese New Year effect may still weigh down the final reading. The sharp decline of small companies' PMI was probably partially attributable to Chinese New Year effect as small companies shut down after migrant workers went back for holiday. ▪ For breakdown, new order and new export order fell to 51 and 49 in Feb respectively from 52.6 and 49.5. New export order has been below 50 for the second consecutive months, first time since 3Q 2016. This may fuel concerns that the support of

	external demand for growth may start to soften. Purchasing price index decelerated further to 53.4 from 59.7, implying easing pressure for PPI. Given price pressure from pork and raw material eased further, we think the inflationary pressure may remain muted in the near term.
▪ Hong Kong total loans and advances increased by 16.4% yoy in January 2018, exhibiting double-digit annual growth consecutively for a year. This is attributed to strong trading activities, upbeat corporate sentiment and robust loan demand from Mainland companies.	▪ Moving forward, trade activities will sustain the growth momentum given strong external demand and will therefore support trade finance (+10.8% yoy, the largest gain since June 2014). Besides, we expect domestic economy to remain resilient and continue to boost local loan demand. Furthermore, the launch of fixed-rate mortgage plans and the retreat of HIBOR helped to reverse the downward trend of approved new mortgage loans (+34.8% yoy and +37.1% mom). However, should global central banks tighten the liquidity at a faster pace than expected, the resultant capital outflow from emerging markets may weigh on risk assets. If this is the case, loan demand from homebuyers, property developers and non-bank financial institutions could reduce. ▪ On the other hand, as funding costs are likely to remain elevated 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. Therefore, loans for use outside of HK (+17.1% yoy) are likely to expand further this year. However, total loan growth may moderate amid high base effect. Therefore, we expect HKD loan-to-deposit ratio to remain high around 80% and prompt banks to lift HKD deposit rates.
▪ In January 2018, HK's RMB deposits dropped for the second consecutive month by 2.3% mom to RMB 546.4 billion despite a stronger RMB (CNH appreciated 3.6% mom against HKD in January) and higher CNH deposit rates. Still, the annual growth of 4.6% reaches its highest level since July 2015.	▪ As the PBOC proactively manages the liquidity, the chance of onshore liquidity getting too tight and affecting offshore yuan liquidity is relatively low in the near term. The re-launch of onshore repo facility to offshore bond investors may also help to improve offshore liquidity. Therefore, we see limited upside for HK's RMB deposit rates. Still, RMB deposit rates remain higher than rates for other currencies. Adding on a relatively strong RMB, HK's RMB deposits are expected to rebound further.
▪ HK's exports and imports surged by 18.1% yoy and 23.8% yoy respectively in January 2018. As a result, trade deficit narrowed to HK$31.9 billion.	▪ The strong performance of trade activities could be attributed to calendar effect. Still, it reflects strong external demand from Asian trading partners, especially Mainland China. Specifically, exports to Mainland China, India, Taiwan and Vietnam rose significantly by 29% yoy, 39.4% yoy, 40% yoy and 23% yoy respectively. On the other hand, imports increase on a broad basis amid higher commodity prices. Looking ahead, trade growth is likely to decelerate notably in February amid calendar effect. Despite that, given sustained economic growth across the globe, we expect Hong Kong's trade activities and economic growth to remain elevated in the first half of this year. A weaker HKD will also support HK's exports. Still, we remain wary of potential trade conflicts due to the rise of trade protectionism.
▪ Macau's GDP growth rallied to 8% yoy in 4Q 2017 as the effect of typhoons ebbed. For 2017 as a while, GDP expanded at its strongest level since 2013 by 9.1% yoy after contracting for three consecutive years. ▪ Macau's visitor arrivals decreased by 4.7% yoy in Janaury 2018 due to calendar effect. Specifically, the number of same-day visitors dropped at the fastest pace since 2009 by 16.8% yoy. This offset	▪ The resilient economic performance was attributed to the broad-based growth across Asia which supported tourism activities and gaming growth. Over 2017, total visitor arrivals increased at the fastest pace since 2014 by 7.5% yoy as overnight visitors rose 9.9% due to new hotel openings since 2016. Meanwhile, China's sustained growth helped to ease the impact of anti-corruption campaign. This together with junket operators' provision of credit extensions has supported the return of VIP demand. Therefore, exports of gaming services

the strong growth of 8.8% yoy in overnight visitors. ▪ Macau's gaming revenue grew at its slowest pace since January 2017 by 5.7% yoy in February 2018, despite a 6.5% yoy increase in total visitor arrivals during Lunar New Year Holiday.	rose by 16.3 yoy while those of other tourism services expanded by 15.4% yoy. In addition, a stable labor market (unemployment rate dropped to the lowest since mid-2015) and wealth effect from stock market helped to support a faster growth of 2.7% yoy in private consumption. With a raft of infrastructure projects under construction, public investment rose slightly by 0.2% yoy. Furthermore, improved external demand pushed exports of goods up by 20.8% yoy. However, private investment continued to decrease notably by 18.4% amid successive completion of mega entertainment projects. ▪ Moving forward, tourism sector and mass-segment of the gaming sector are expected to benefit from infrastructure improvement (including the completion of Hong Kong-Zhuhai-Macau Bridge), new wave of mega project openings, a weaker MOP and Asia's benign growth outlook. Therefore, even though VIP segment is succumbed to liquidity risk and policy risk, gaming sector is likely to sustain growth momentum albeit at a moderate pace. As such, we expect job opportunities to increase and underpin private consumption. On the other hand, government's proposal to improve infrastructure will translate into sustainable growth of public investment. Nevertheless, private investment may remain subdued as major projects will be completed successively. Adding on a high base effect, GDP is expected to expand at a moderate rate of 7% yoy in 2018.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY recovered from low of 6.3000 to above 6.3400 last week in line with the recovery of broad dollar in the global stage after market tried to re-price the Fed rate hike expectation. ▪ RMB index recovered to 96.27 last Friday.	▪ The weakness of RMB was mainly attributable to two factors in our view including the broad dollar recovery and concerns about potential trade war. Nevertheless, given the direct impact of steel and aluminium tariff on China is very limited, we think the impact on RMB is unlikely to be significant. We doubt China will use RMB as weapon in this round of trade tension as China has allowed market to play a bigger role in RMB. Market will closely monitor the development NPC this week.

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