Highlights

Four exchange of tariff blows within four consecutive days. That is how market was swamped with news flow last week. In less than a week, the US-China trade tension has moved from round 1 to round 3 at a much faster than expected pace. China demonstrated no fear of trade war last Monday via introducing a reciprocal tariff on US$3 billion worth 128 US products in the first round. On Wednesday, China's swift US$50 billion tit-for-tat move brought the game to the second round. The raise of stake to total US$150 billion by President Trump on Thursday shows that we will probably face the third round soon. The latest emergent press conference by China's Commerce Ministry last Friday showed clearly that China is likely to fight to the end at any cost even they are unable to match the amount in the third round. Nevertheless, we think the more than expected hawkish comments from China is the strategy China tried to use to force the US to go back to the negotiation table. Negotiation is still in our baseline. The higher stake usually means higher chance to reach the deal as the cost of no deal could be too high for both countries.

The ball is back to the US. The next two months will be critical as both side will try to negotiate a better deal before the USTR finalize its lists of products after the public hearing on 15 May. For this week, two important event risks to follow regarding the trade tension. First, focus will be on President Xi's speech in Boao forum on Tuesday. We expect President Xi to roll out more plans to open China's financial market. Whether President Xi's opening tone is likely to water down the tension will be seen. Second, the US Treasury Semi-annual report on international economic and exchange rate policy will be due on 15 April. Market will monitor closely on whether the exchange rate policy will be used as alternative tool in the trade tension by Trump Administration.

On currency, the recent movement of RMB probably has entered a binary scenario hinging on market expectation on China's possible reaction to the trade tension. If China is likely to compromise, RMB may appreciate. However if China decides to fight to the end, RMB may depreciate. The recent hawkish comments from China added pressure for RMB to weaken.

In its first meeting, the newly upgraded Central Economic and Financial Affairs Commission the idea of structural de-leverage. Over the years, China's de-leverage strategy has evolved. China is moving from universal de-leverage to structural de-leverage targeting local governments and state-owned companies. China will give priority to leverage problems that may threaten economic stability. However, China is unlikely to purse deleverage which may create new systemic risk.

In **Hong Kong,** retail sales surged by 29.8% yoy significantly in February 2018. Driven by the low base effect and calendar effect of Chinese New Year, the retail sales in February increased on a broad basis. Instead, with the subsidence of low base effect and calendar effect, the growth of retail sales is likely to decelerate in the coming months. Despite that, we hold onto our view that the retail sector will have better performance in this year compared to last year, amid the positive economic outlook. In **Macau**, gaming revenue grew at a faster pace by 22.2% yoy to MOP 25.95 billion in March 2018, exhibiting the positive growth consecutively for the twentieth month. VIP revenue has remained the major driver of gross gaming revenue. Instead, we are still wary of the sustainability of VIP revenue growth. With the high base effect, we hold onto our view that the growth of gaming revenue will decelerate to 10%-15% yoy in 2018.

Key Events and Market Talk

Facts	OCBC Opinions
▪ The US-China trade tension escalated significantly last week after China decided to exchange blows with the US on tariff. ▪ China has shown its hand in our view by proposing a tariff on key US imports including aircraft, soybean and cars. ▪ In addition, China's Commerce Ministry vowed to fight to the end at any cost on Friday in its emergent press conference in reaction to President Trump's instruction to the USTR to consider tariffs on additional US$100 billion products.	▪ In less than a week, the US-China trade tension has moved from round 1 to potential round 3 at a much faster than expected pace. ▪ **Round 1: No fear.** China's reciprocal tariff on 128 US products worth about US$3 billion officially took effect from last Monday in reaction to US's steel and aluminium tariff under section 232 investigation. The move demonstrated that China is not fear of direct confrontation. ▪ **Round 2: Tit-for-tat.** Immediately after the USTR unveiled the US$50 billion proposed tariff list of about 1300 Chinese products under the investigation 301, China announced a tit-for-tat move to target all major US imports including aircraft, soybean and vehicles. Frankly speaking, China's swift reaction exceeded our expectation as China is running the risk of higher domestic inflation by taxing soybean. We expect China's CPI to go up by about 0.2% should the import tariff on US soybean take effect.

	Nevertheless, the tit-for-tat move shows that China may change to "the war that will end war" strategy to force the US back to the negotiating table. Bear in mind that both tariffs are just proposal and has not taken effect. The next month could be critical as the USTR will host its public hearing on 15 May to finalize its tariff lists. Should the negotiations fail, we think we may enter a full-fledged trade war. ▪ **Round 3: Beyond the boundary.** Unfortunately, the uncertainty did not stop at round 2 after President Trump brought the potential stake to about US$150 billion after he instructed the USTR to consider tariff on additional US$100 billion products. China is unlikely to match the stake as data from Chinese customs shows that China only imported total US$155 billion products from the US in 2017. Nevertheless, as mentioned by China's Commerce Ministry clearly that China is likely to fight to an end and China's retaliation measures are not restricted to trade. Although the US Treasury Secretary Steven Mnuchin said he is not worried about China selling Treasuries, the escalation to beyond trade may inject lots of volatility to the financial market. ▪ President Xi will give market more insights about China's reaction as he will deliver a key note speech in BoAo forum on Tuesday. We expect President Xi to reiterate China's commitment to market opening as a soft gesture. However, he is also likely to send more warning shots that China is not fear of fighting. We think the ball now is back to the US side. Whether the tension will be escalated to a full-fledged war will probably depend on the US's decision. At the current stage, we also cannot rule out those alternative retaliation measures such as RMB depreciation, Sale of US Treasuries as well as restricting the market access to US companies.
▪ The newly upgraded Central Economic and Financial Affairs Commission host its first meeting chaired by President Xi. ▪ The meeting reiterated China's three plans for the next few years including containing financial risk, targeted poverty reduction and environmental protection.	▪ The key highlight from the meeting is the idea of structural de-leverage. Over the years, China's de-leverage strategy has evolved. China is moving from universal de-leverage to structural de-leverage targeting local governments and state-owned companies. ▪ China will give priority to leverage problems that may threaten economic stability. However, China is unlikely to purse deleverage which may create new systemic risk.

Key Economic News

Facts	OCBC Opinions
▪ China's FX reserve in March rebounded slightly to US$3.1428 trillion.	▪ Overall cross border flow remained largely balanced in March. The small increase of FX reserve was mainly the result of valuation effect as dollar weakened slightly in March.
▪ Hong Kong's retail sales surged by 29.8% yoy significantly in February 2018.	▪ Driven by the low base effect and calendar effect of Chinese New Year, the retail sales in February increased on a broad basis. Sales of food picked up by 30.4% yoy, the largest increase since February 2015. From the perspective of other major retail outlets, sales of clothing and footwear jumped by 42.2% yoy. Supported by the further improvement in HK's tourism, including a weaker HKD to encourage tourist spending, the sales of consumer durable goods and luxurious goods swelled by 28.1% yoy and 33.7% yoy respectively. Meanwhile, optimistic consumer sentiment promoted by the steady labor market has boosted the domestic consumption. Notably, with the

	subsidence of low base effect and calendar effect, the growth of retail sales is likely to decelerate in the coming months. Despite that, we hold onto our view that the retail sector will have better performance in this year compared to last year, amid the positive economic outlook.
▪ Macau's gaming revenue grew at a faster pace by 22.2% yoy to MOP 25.95 billion in March 2018, exhibiting the positive growth consecutively for the twentieth month.	▪ VIP revenue has remained the major driver of gross gaming revenue. Instead, we are still wary of the sustainability of VIP revenue growth. As the Macau's government has started to tighten the regulations on the gaming industry and the standards for licensing junket operators since January 2018, policy risk may hinder the growth of VIP segment. Besides, the funding cost is expected to increase progressively. As such, junket operators may be impeded from providing credit extensions for VIP gamblers. Under this circumstance, affected by the policy risk and liquidity risk, VIP segment's contribution to gaming growth is likely to decline. ▪ In contrast, driven by the positive economic outlook and a series of new hotel and casino openings, mass-market may make more contributions to the gaming growth in the longer term. Still, the gaming growth led by mass-market segment may be weaker than the growth driven by high rollers. Therefore, including high base effect, we hold onto our view that the growth of gaming revenue will decelerate to 10%-15% yoy in 2018.
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RMB	
Facts	**OCBC Opinions**
▪ In a holiday shorten week, RMB weakened slightly with the USDCNY returned to above 6.30.	▪ The recent movement of RMB probably has entered a binary scenario hinging on market expectation on China's possible reaction to the trade tension. If China is likely to compromise, RMB may appreciate. However if China decides to fight to the end, RMB may depreciate. The recent hawkish comments from China clearly added pressure for RMB to weaken.

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