Highlights:

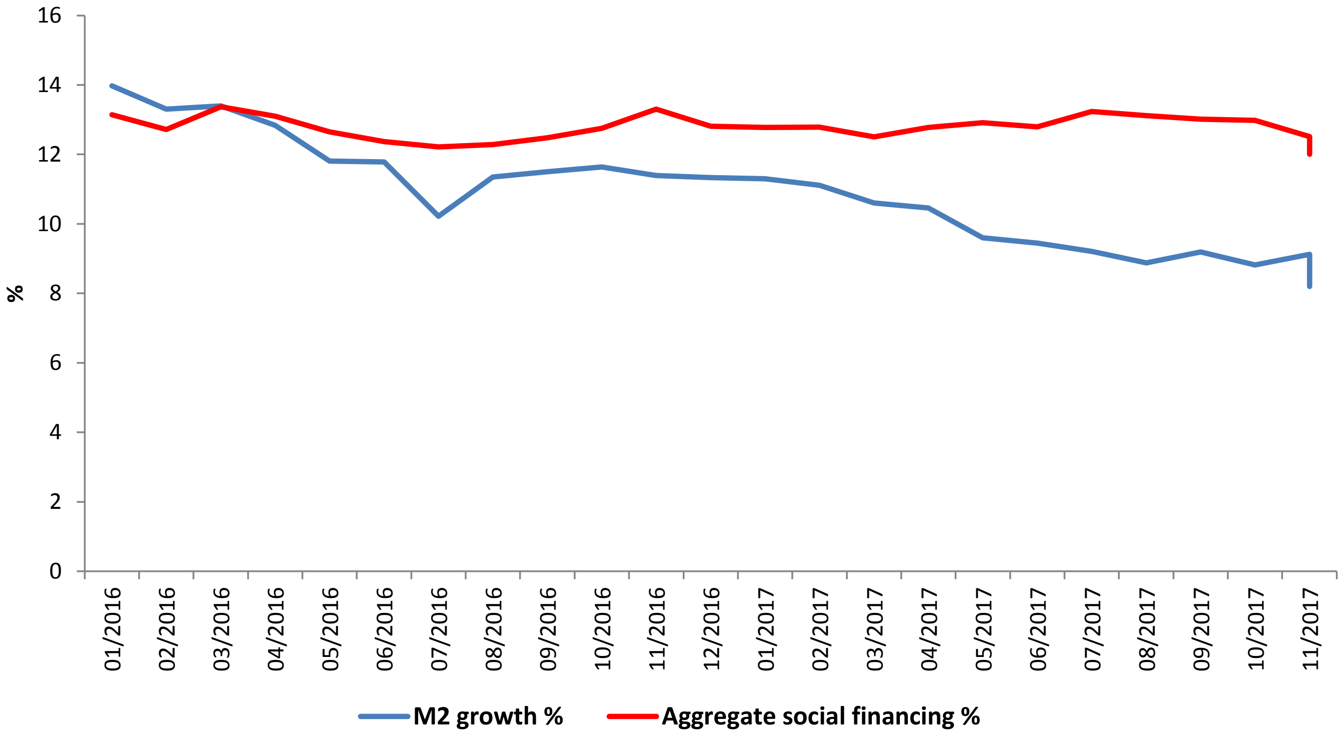
There is no sign of fatigue of financial regulation tightening in China. The CBRC unveiled regulation 4 over the weekend to deepen its clampdown on financial chaos to contain financial risks. The CBRC also identified eight areas of risks as its key tasks to contain in 2018. The "endless" financial regulatory tightening continued to weigh down China's bond market with 10-year China Development Bank bond yields returned to 5%.

The volatility in global FX and rates market was woken up last week partially driven by China factors including China's removal of the counter cyclical factor in its daily fixing and rumour about China's US Treasury holding strategy. We think the spike of RMB volatility is due to market misunderstanding of the CCF mechanism. RMB fixing formula change is not a big deal and market may have over read this news. The recent break of 6.5 reinforce our view that the removal of the CCF is not a message sent by the PBoC to weaken RMB. We think the near-term outlook will still depend on the US dollar.

All China's December financial data missed the consensus by a wide margin. However, we do not think the latest credit data was the result of worsening demand matrix. Instead, the wider forecast error was probably the result of underestimating the impact of tighter regulatory changes. The gap between aggregate social financing growth and M2 growth widened to a record level in 2017.This shows two things. First, China's financial de-leverage has started to take effect. Second, M2 is no longer an important leading indicator for Chinese economy. China's trade surplus with the US reached a record high of US$277.97 billion in 2017. This may lead to higher risk of trade dispute in 2018, which may in turn become one of the supporting factors to RMB.

In Hong Kong, one-month HIBOR stabilized. Previously, we have mentioned that potential large IPOs may lock up liquidity and push up HIBOR. The latest example is C-Mer Eye Care IPO which is said to be over 1,500 times oversubscribed and lock up about HK$89.8 billion. Given HKEX's revamp of IPO rules, which will take effect in mid-2018 and allow dual-class shares for listing companies, we expect more renowned Chinese high-tech companies to launch their IPO on HKEX. This reinforces our expectations that a new wave of IPOs may keep HIBOR elevated this year. On the other hand, HK Legislative Council passed an amendment bill which extends the stamp duty exemption period from 6 months to 12 months for upgraders. We expect the amendment to have two implications. First, prospective upgraders may be encouraged to enter the market. Second, it may be less imminent for the second home buyers to sell their first home and in turn allow them to ask for a better price. All in all, the amendment could translate into some upward pressure to both housing transaction volume and home prices. However, such upward pressure may not be able to offset the downward risks from higher interest rates and increasing new home supply. Adding on a high base effect, we hold onto our view that housing prices growth will decelerate in 2018.

Chart of the week: The widening gap between China's M2 growth and aggregate social financing growth shows that China's financial deleverage is taking effect. Meanwhile, M2 is no longer a good leading indicator for the Chinese economy.



Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China banking regulator CBRC unveiled the regulation 4 over the weekend to deepen its clampdown on financial chaos to contain financial risks.	▪ The CBRC said the tightening measures in 2017 have achieved its first stage of success and financial chaos such as multi-layer product and financial leverage have been contained. ▪ The CBRC also said it will clamp down on key risks in eight areas in 2018 including 1) unhealthy corporate governance, 2) violation of macro prudential policy, credit policy and property industry policy, 3) shadow banking, 4) damages in financial consumer interests, 5) interest transfer, 6) misconduct of business, 7) operational risk and 8) financial corruption.
▪ Although China's central bank did not admit directly that it has suggested the RMB fixing submitter not to use the counter cyclical factor (CCF) in its reply to Bloomberg's enquiry on 9 January, the daily fixing in the past few days, which is in line with market forecast without the use of CCF, have confirmed that the CCF has been temporarily dropped from the fixing mechanism.	▪ We think the spike of RMB volatility is due to market misunderstanding of the CCF mechanism. ▪ The CCF was introduced in late May 2017 as a mathematic solution to solve RMB's asymmetric depreciation problem. Thanks to the favourable macro backdrop of weaker US dollar in 2017, the introduction of CCF is a big success and it helped China break the vicious cycle of RMB's self-fulfilling depreciation within a short timeframe. Since the last quarter of 2017, the role of the CCF has diminished significantly in the daily fixing. As such, it is the time for the CCF to take a backseat. ▪ The removal of CCF shows China is comfortable with the current market expectation about RMB in our view. However, we doubt it is a message from the PBoC that RMB exchange rate against the dollar is too strong. On trade weighted basis, RMB remains relatively stable against its major trading partners.
▪ China's currency regulator SAFE denied the media report that China may slow or even halt the purchase of US Treasuries. The SAFE said the news may quote the wrong source or may be the fake news. China's purchase of US Treasury will depend on the market condition.	▪ Although the use of "may be the fake news" may not be convincing for some investors, we think there is no reason for market to doubt SAFE's denial. In general, we think China's purchase of US Treasury will depend on the market condition.
▪ One-month HIBOR continued to subside albeit at a slow pace. Previously, we have mentioned that potential large IPOs may lock up liquidity and push up HIBOR. The latest example is C-Mer Eye Care IPO which is said to be over 1,500 times oversubscribed and lock up about HK$89.8 billion.	▪ Given HKEX's revamp of IPO rules, which will take effect in mid-2018 and allow dual-class shares for listing companies, we expect more renowned Chinese high-tech companies to launch their IPO on HKEX. This reinforces our expectations that a new wave of IPOs may keep HIBOR elevated this year.
▪ Hong Kong Legislative Council passed a stamp duty amendment bill on 11 January 2018. According to the amendment, the buyers of a second home will be allowed to obtain a full rebate of the 15% stamp duty if they manage to sell their first home within 12 months (an extension from the previous 6 months) of the new flat being bought.	▪ The government rolled out new cooling measures to impose a flat 15% stamp duty tax on non-first-time home buyers which has been in effect since November 2016. This added to the cooling measure unveiled by the HKMA in May 2017 in deterring households from upgrading their homes. As a result, secondary housing market has been in short supply, which results in low transaction volume and high transaction price. Specifically, total housing transaction volume dropped by 6.1% yoy while total housing transaction value rose by 6.8% yoy during May and December 2017. Against this backdrop, we expect the amendment to have two implications. First, prospective upgraders may be encouraged to enter the market. Second, it may be less imminent for the second home buyers to sell their first home and in turn allow them to ask for a better price. All in all, the amendment could translate into some upward pressure to both housing transaction volume and home

	prices. However, such upward pressure may not be able to offset the downward risks from higher interest rates and increasing new home supply. Adding on a high base effect, we hold onto our view that housing prices growth will decelerate in 2018.
▪ It is reported that during the first fortnight of 2018, at least four major property companies have announced plans to raise a total of $2.6 billion by issuing medium-term notes or bonds in offshore markets.	▪ Onshore bond market rout has been fueled by new wave of regulations unveiled in the first week of 2018. Looking ahead, as Chinese authorities will focus mainly on containing financial risk and cracking down on financial leverage this year, we expect liquidity condition to remain relatively tight and bond market to remain under pressure in the onshore market. This will shift funding needs of Chinese companies which need to repay their mounting debt or are keen on business expansion to offshore markets. Therefore, we expect loans for use outside of HK to remain elevated in the coming months.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's monetary and credit expansion slowed at a more than expected pace in December. ▪ Broad money supply M2 decelerated to 8.2%, lowest since record.	▪ All December financial data missed the consensus by a wide margin. However, we do not think the latest credit data was the result of worsening demand matrix. Instead, the wider forecast error was probably the result of underestimating the impact of tighter regulatory changes. ▪ New Yuan loan increased by CNY584.4 billion, lowest reading since July 2016. This is mainly the result of bank's withdraw of loan support as banks have run out of their loan quota after the rapid expansion in the first 11 months. For breakdown, medium to long term loan to household and corporates slowed down to CNY311.2 billion and CNY205.9 billion in December. ▪ Aggregate social financing increased by CNY1.14 trillion in December. Despite weaker than expected on-balance sheet lending due to restriction of loan quota, off balance sheet lending remained strong led by trust loan, which increased by CNY229 billion. The steady off-balance sheet lending shows that loan demand remained solid. Net corporate bond financing remained weak increasing only by CNY62.1 billion due to bond sell-off in the past few months. ▪ The gap between aggregate social financing growth and M2 growth widened to a record level in 2017. M2 decelerated to 8.2% yoy while aggregate social financing grew by 12% yoy in line with government target. The sharp deceleration of M2 growth in December was partly due to the sharp decline of non-bank financial institution's deposit which fell by CNY912.9 billion as tighter regulatory measures such as macro prudential assessment as well as other liquidity measures have forced financial institutions to lower their leverage. The widening gap between aggregate financing growth and M2 shows that China's financial de-leverage has started to take effect.
▪ China's trade surplus unexpectedly widened to US$54.7 billion in December, highest since January 2016. The widening trade surplus was mainly due to unexpected import growth, which only grew by 4.5% yoy in dollar term. Export growth remained steady growing by 10.9% yoy.	▪ China continued to benefit from the synchronized growth story in December with demand from US, EU and Japan remained strong. Exports to US, EU and Japan grew by 12.7% yoy, 12.7% and 14.9% yoy respectively. ▪ The weaker than expected import growth was mainly due to the decline of iron ore imports by value as well as the sharp slowdown of imports of electronic integrated circuit. Imports of iron ore fell by 9.86% yoy although demand for crude oil

	remained strong increasing by 21.38% by value. ▪ The sharp decline in demand for integrated circuit may raise the concern about the global tech cycle as it may be due to weaker global order. Should the slowdown persist, it may not bode well for export outlook in 2018. ▪ China's trade surplus with the US narrowed slightly to US$25.55 billion in December. However, total trade surplus with the US reached a record high of US$277.97 billion in 2017. This may lead to more higher risk of trade dispute in 2018, which may in turn become one of the supporting factors to RMB.
▪ According to Financial Secretary Paul Chan Mo-po, fiscal surplus for the first eight months of this fiscal year reached HK$57.2 billion, much stronger than the previously expected HK$16.3 billion.	▪ This is attributed to robust performance of the stock market and housing market. Specifically, the value of housing transactions totaled HK$556.3 billion in 2017, its highest level since 2010. Besides, the proceeds from land sales reached HK$90.813 billion during April 2017 to December 2017 after registering HK$109.5 billion in the preceding fiscal year. Furthermore, daily average turnover of Hong Kong Stock Exchange "Main Board" increased to HK$87.6 billion over 2017 from HK$66.4 over 2016. Given strong fiscal surplus, we expect public investment and government spending to remain resilient in 2018 and support economic growth.
▪ Macau: Housing transactions increased by 5.2% mom to 936 deals in November 2017, which reflects upbeat sentiment in the primary housing market. Nevertheless, housing transactions dropped on yearly basis for the fourth consecutive month by 27.8% yoy. Approved new mortgage loans (+44.9% mom) also fell for the fourth straight month by 9.8% yoy to MOP4.06 billion. Average housing prices fell by 2.8% YTD in November 2017. ▪	▪ Secondary housing market has been cooled down by new property control measures and higher borrowing costs. Therefore, the performance of housing market as a whole in 2H 2017 was weaker than the same period of 2016. ▪ Moving forward, we expect more new home projects to be launched in the coming months as housing completions soared by 989% yoy to 4314 units during the first eleven months of 2017. Though we expect housing transactions to remain muted in the secondary market, primary market may remain supported by positive economic outlook, wealth effect from stock market and solid labor market. Therefore, average housing price is likely to stabilize around its current level. ▪ In the longer term, with more major central banks to join the tightening camp, capital outflow risk may be intensified and result in higher interest rates and correction in the stock market. If this is the case, we expect housing demand to take a hit. However, any correction in the housing market may be capped by limited supply and strong economic growth. Specifically, housing starts decreased by 36% yoy to 3104 units during the first eleven months of 2017 after a 6% yoy fall in 2016. This indicates that medium-term supply of new private homes will remain scarce. On the other hand, 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.

RMB	
Facts	**OCBC Opinions**
▪ RMB weakened initially in the first half of the week following the news of the tweak of fixing mechanism, however, it rebounded riding on the weaker dollar. The USDCNY ended the week around 6.46.	▪ As we argued in a separate report that RMB fixing formula change is not a big deal and market may have over read this news. The recent break of 6.5 reinforce our view that the removal of the CCF is not a message sent by the PBoC to weaken RMB. We think the near-term outlook will still depend on the US dollar.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com