Highlights

Hopes on near term stabilization for Chinese economy heightens after China's March PMI rebounded strongly back to expansionary territory, overshadowing the weak industrial profit data for the first two months. Seasonal pattern played an important part for the mixed reading between March and first two months of 2019 as this year's Chinese New Year came earlier. Nevertheless, looking at the details from the PMI, the recovery is beyond the seasonal pattern in our view. The sharp rebound of PMI for medium and small enterprises show that supporting measures from the government such as VAT cut may start to take effect.

On industries, China's two important pillars to the economy including auto sector and property sector may show divergent trend. The shoe finally dropped for China's subsidy policy for electronic vehicles. China will cut its subsidy from June 2019 by half and phase out completely in 2020. As China will only phase out subsidy gradually at a measured pace, it may lead to front loading of purchase of EVs in the near term, which could provide some supports to car sales. The news from property sector is more encouraging with the premium for land acquisition increased strongly in March, signalling the return of confidence.

On monetary policy, in a rare case, China's central bank denied the rumours that China has cut the RRR via its social media account. Given China's economic data are likely to recover in March, there is no urgency for China to roll out any imminent measure. However, market will focus on how China wants to deal with its maturing MLFs in April. The chance of RRR cut cannot be ruled out.

On US-China trade talk, positive headline continue to surface. However, given the talk has entered the deep water zone such as high tech and cybersecurity, which used to be China's red line, the talk could remain prolonged. On currency, RMB has remained a dollar play last week for most of time until Friday. The rebound of RMB is expected to push the RMB index higher again. The recent dovishness of global central banks and the return of capital inflows are expected to support RMB though market will continue to wait for the outcome of US-China trade talk.

In **Hong Kong,** with the return of carry trade, USDHKD spot touched 7.85 again, prompting the HKMA to buy another HK$10.543bn and pushing aggregate balance down to HK$54.2bn. Moving ahead, we expect 1M HIBOR and 3M HIBOR will fall below 1.5% and 1.7% respectively. With USD-HKD yield differential to widen further, we expect USDHKD spot will continually touch 7.85 and trigger liquidity withdrawal. However, we still expect that any further liquidity withdrawal will remain moderate (see below for details). On the other hand, the percentage share of HKD CASA in total HKD deposits rebounded to 58.9% in February from a nearly 10-year low. As the Fed now expects no rate hike in 2019 and will cease the balance sheet cut earlier than the original plan, HKD interest rates including deposits rates are more likely to stabilize or drop than to rise. As such, HKD time deposits (1.5% mom) is expected to retreat gradually. Meanwhile, HKD CASA (+1.4% mom) may rebound gradually with the rally in property and stock markets as well as the banks' sweeteners offered to attract CASA. In conclusion, the funding pressure will likely ease for the banks this year. Adding on the Fed's pause, we see little chance of prime rate hike in 2019. Finally, the HKMA grants three virtual bank licenses. This reinforces that HK has been striving to promote Fintech development. In the near term, against the backdrop of flushed liquidity, even if the virtual banks lift deposit rates to lure customers, the upside to deposit rates across the banking system is expected to be limited.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ The US-China trade talk has entered the deep-water zone with the focus moved to China's cybersecurity law as well as high tech sectors such as cloud computing according to the media.	▪ Although both sides share the optimism that progress has been made, the move of US-China trade talk to sensitive areas such as high tech and cybersecurity, which used to be China's red line, suggest that there is no easy and quick fix to the bilateral discrepancy.
▪ JP Morgan and Nomura received the approval from China's security regulator to set up the foreign controlled brokerage joint venture	▪ As part of China's plan to open its domestic financial system, it is expected that more foreign financial institutions are likely to open its foreign controlled brokerage or even banks in China.
▪ Premier Li Keqiang reiterated China's commitment to open its financial sector in the Boao forum. Meanwhile, he also hinted that China's growth has rebounded strongly in March.	▪ Based on Premier Li's comments, we think China's industrial production is likely to rebound in March. However, part of rebound was mainly due to seasonal pattern. ▪ Premier Li also reiterated that China will not go back to excessive easing path. However, he did mention that China may step up the supporting measures should the economic growth weaken by more than expected.

▪ In a rare case, China's central bank denied the rumors that China has cut the RRR via its social media weibo account.	▪ Given China's economic data are likely to recover in March, there is no urgency for China to roll out any imminent measure. However, market will focus on how China wants to deal with its maturing MLFs in April.
▪ Quota for qualified domestic institutional investors (QDII) increased to US$103.233 billion in March from US$101.446 billion.	▪
▪ China announced to cut its subsidy to new energy vehicles. Subsidies for pure battery EVs with driving range of 400km will be cut by half from June 2019. The subsidy will phase out completely from 2020.	▪ The shoe finally dropped. The reduction of subsidy aims to drive out the low quality development and push car companies relying on innovation. As China will only phase out subsidy gradually at a measured pace, it may lead to front loading of purchase of EVs in the near term, which could provide some supports to car sales.
▪ The USDHKD spot touched 7.85 again last Thursday with the return of carry trade and the strong USD demand across quarter-end. To defend the currency peg, the HKMA bought another HK$10.543bn and drove aggregate balance to HK$54.2bn on 1st Apr.	▪ Due to the continuous equity inflows, the rising speculation on a pause in global monetary tightening and the absence of large IPOs in near term, market increasingly expected that flushed HKD liquidity will sustain. As such, quarter-end effect abated sooner than expected and led the HIBOR to subside across the curve. ▪ Moving ahead, we expect 1M HIBOR (1.65%) and 3M HIBOR (1.76%) will fall below 1.5% and 1.7% respectively. With USD-HKD yield differential to widen further, we expect USDHKD spot will continually touch 7.85 and trigger liquidity withdrawal. ▪ However, after quarter-end, USD demand may not be very strong. Besides, different from last year when HKMA liquidity withdrawal coincided with large equity outflows, this time round, we see resilient equity inflows on major central banks' pause in monetary tightening. This may help to weather some downside risk from carry trade to the HKD. Furthermore, as aggregate balance shrank by 22.4% in March, carry trade is expected to stay cautious in case more liquidity withdrawal would drive up HKD rates and HKD spot. ▪ Taken all together, it suggests that any further liquidity withdrawal will remain moderate and have limited impact of the sizeable monetary base (over HK$1.6 trillion). Aggregate balance will more likely to fall orderly.
▪ After launching the fast payment system in September 2018, the Hong Kong Monetary Authority (HKMA) grants three virtual bank licenses and is "actively processing" the other five applicants.	▪ This reinforces that HK has been striving to catch up with Shenzhen in terms of Fintech development. In the near term, these virtual banks will only offer traditional deposit, loan and remittance services to HK residents. Against the backdrop of very flushed liquidity, even if the virtual banks lift deposit rates to lure customers, the upside to deposit rates across the banking system is expected to be limited. Nevertheless, in the longer term, any further development of virtual banks may lead to fierce competition among banking system and in turn bring up the deposit rates. ▪ On the other hand, deeper collaboration in Fintech development in the Greater Bay Area could be expected. First, the Fintech may help to integrate and improve the financial sector's big data base. Second, the Fintech Supervisory Sandbox launched by the HKMA in September 2016 may be extended to the rest of the bay area, in order to bolster the development of Fintech across the area. Third, the GBA blockchain-based trade finance platform was launched in Shenzhen last September with trading volume reached RMB209 million in less than two months. Another one in HK

	was also unveiled last October. The governor of Shenzhen PBOC said they are promoting second phase of GBA blockchain-based trade finance platform which will cover cross-border trade and integration of tax and custom in the future. Fourth, Fintech may be leveraged to improve livelihoods, like cross-border payment for healthcare, transportation, community services and so on.

Key Economic News

Facts	OCBC Opinions
▪ China's official PMI rebounded strongly to 50.5 from 49.2 in February, back to expansionary territory for the first time since November 2018.	▪ Both supply and demand recovered in March. On supply, production rebounded to 52.7 from 49.5. On demand, both new orders and new export orders improved to 51.6 and 47.1 respectively from 50.6 and 45.2. PMI purchasing price index rose further to 53.5 from 51.9. This may support the PPI to stay above zero, easing deflationary concern on producer prices. ▪ The rebound of March manufacturing activity was partly due to seasonal effect as the 15th day of lunar month fell in February and manufacturing factories restarted earlier this year as compared to last year. ▪ Interesting to note that PMI for large enterprise fell slightly to 51.1 from 51.5 while PMI for medium and small enterprises rebounded to 49.9 and 49.3 respectively from 46.9 and 45.3. The strong rebound of confidence from medium and small enterprises could be the result of supporting measures from government such as the VAT cut. ▪ The strong PMI data is likely to repel the concern about the sharp slowdown in China. The Chinese economy may try to search the bottom in the near term on the back of proactive fiscal policy and more flexible monetary policy.
▪ China's industrial profit tumbled by 14% yoy in the first two months of 2019.	▪ Industrial profit in manufacturing sector fell by 15.7% yoy. ▪ As a lagging indicator, the weak industrial profit echoed China's weak industrial production in the first two months, which was partially distorted by Chinese New Year effect. Meanwhile, it was also due to the sharp deceleration of producer prices. The weak industrial profit is likely to be overshadowed by the strong March PMI.
▪ HK's total loan growth continued to decelerated to 3.03% yoy in February, the weakest at since August 2016.	▪ Though risky asset prices rallied on increasing expectation of loose global liquidity, HK's loan demand remained subdued. First, trade finance dropped for the sixth consecutive month by 7.4% yoy to HK$477.7 billion as weakening external demand and lingering trade tension continued to weigh down HK's trade activities. Second, loans for use in HK (excluding trade finance) grew at a slower pace by 3.5% yoy to HK$6.36 trillion. Though eased concerns about higher interest rates as well as US-China trade truce helped to revive investment sentiment, loan demand remained cautious probably due to concerns about external uncertainties. Specifically, despite rally in property market, approved new mortgage loans fell for the fourth consecutive month by 19.8% yoy to HK$26.05 billion. Third, the growth of loans for use outside of HK rebounded from 3.8% yoy to 4.0% yoy. Lately, China's monetary easing has brought Mainland China's financing demand back to the onshore market. However, with the Fed's pause in rate hikes, it is likely for USD-CNH yield differential to

	remain wide. As such, unless the PBOC further loosens the monetary policy, it is possible for the growth of loans for use outside of HK to stabilize. All in all, we hold onto our view that total loan growth will remain benign against the backdrop of faltering global growth and lingering trade tension. For the total loans in 2019, we expect to see lower single-digit growth than last year's 4.4% yoy.
▪ HKD loan-to-deposit ratio (LDR) rose to the highest since 2003 at 87.3% in February as HKD loans grew by 0.7% mom while HKD deposits advanced at a relatively slow rate of 0.2% mom.	▪ Nevertheless, we expect the upside to the LDR to be smaller than the downside as loans growth is likely to remain benign while deposits may rebound. In terms of HKD deposits, we note that the decline in HKD demand and savings deposits rose for the second straight month by 0.6% mom and 1.8% mom respectively. Meanwhile, HKD time deposits retreated by 1.5% mom. As a result, the percentage share of HKD CASA in total HKD deposits rebounded to 58.9% in February from a nearly 10-year low of 58.2% seen in the previous month. As the Fed now expects no rate hike in 2019 and will cease the balance sheet cut earlier than the original plan, HKD interest rates including deposits rates are more likely to stabilize or drop than to rise. As such, HKD time deposits is expected to retreat gradually. On the other hand, HKD CASA may rebound gradually with the rally in property and stock markets as well as the banks' sweeteners offered to attract CASA. In conclusion, the funding pressure will likely ease for the banks this year. Adding on the Fed's pause, we see little chance of prime rate hike in 2019.
▪ HK's RMB deposits rebounded by 1.5% mom to RMB608.3 billion in February.	▪ As the expectation about more PBOC easing subsided temporarily while speculation on Fed's pause increased, RMB assets became more attractive. Besides, capital inflows to Mainland China may sustain given China's further opening-up, the upcoming increase in the weight of A-shares in MSCI index and the inclusion of A-shares as well as China's bonds into global indexes. This may in turn boost the offshore demand for RMB. Furthermore, RMB's outlook has been improved. In conclusion, we believe that RMB deposits will remain resilient in HK over the coming months.
▪ HK's trade data surprised to the downside in February, mainly due to the different timing of Chinese New Year between this year and last year.	▪ Due to the front-loading of exports ahead of CNY holiday, exports weakened notably after the holiday and shrank by 6.9% yoy, the largest drop in three years. In contrast, with the delay of imports after CNY holiday, the decrease in imports narrowed from -6% yoy in January to -3.8% yoy in February. ▪ Nevertheless, even if we take the first two months as a whole, exports and imports still dropped by 3.1% yoy and 5.0% yoy respectively. By country, imports from the two largest partners Mainland China and Taiwan plunged by 4.9% yoy and 10% yoy during the first two months of 2019. Exports to Mainland China (-4.5% yoy), the US (-12.4% yoy), India (-37.4% yoy), Japan (-6.9% yoy), Taiwan (-21.9% yoy) and Germany (-7.6% yoy) also slid notably during January to February. This suggests that the lingering trade tensions and faltering global growth have dented external demand despite US-China trade truce. ▪ Moving ahead, external demand is expected to remain subdued given the persistent decline in major economies' manufacturing PMI and the broad-based downward adjustment of 2019 GDP forecast. We will closely monitor the upcoming US-China trade talk. At this juncture, we still believe

	that the US or China will not remove the existing tariff anytime soon. The US may even escalate the trade war to a technology war and in turn hit Asian electronic value-chain. If this is the case, HK's trade sector and its economy will highly likely feel the pain as the city's imports and exports of electrical machinery, telecommunications and office machines took up 61.4% of its total imports and exports.
▪ Macau's unemployment rate held static at a nearly four-year low of 1.7% during the three-month period through February.	▪ However, employed population dropped from 391.5K to 388.1K while the participation rate edged lower from 71.5% to 70.8%. This signals slackening in the labor market. The employment situation of various industries was also mixed. The employed population of hotels, restaurants and similar activities grew by 2.14% mom to 57.2K, the highest level since 2Q 2018. This is mainly attributed to the robust tourism. On the other hand, the employed population of gaming industry and retail industry reduced by 3.1% mom and 3.4% mom respectively. Against the backdrop of weakening global growth outlook and lingering trade tension, the increase in tourists did not translate into higher visitor spending or stronger gambling demand. As such, the hiring sentiment of both gaming and retail sectors remained suppressed. Finally, as most of the mega projects have been completed, the employed population of construction sector slid by 2.4% mom. In the near term, strong tourism may help to buoy the labor market. However, we doubt the sustainability of the low unemployment rate in the medium term given the slowing economic growth in Macau and across the globe.

RMB

Facts	OCBC Opinions
▪ The USDCNY shot up last week testing 6.75 as a result of rebound of broad dollar. However, the 6.75 resistance held well and the pair ended the week back to 6.71 range. RMB index held up well at around 95 and is expected to rise this morning.	▪ RMB has remained a dollar play last week for most of time until Friday. The rebound of CNY despite stable dollar index is expected to push RMB index higher again. The recent dovishness of global central banks and the return of capital inflows are expected to support RMB though market will continue to wait for the outcome of US-China trade talk. ▪ RMB swap points moved higher last week due to widening US-China yield differential. Meanwhile, the increasing capital inflows may also keep the points bidded due to rising hedging demand. The points are expected to remain elevated in the near term.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com