Highlights

The US and China concluded the latest trade talk in Washington with limited details. Nevertheless, the upbeat message from President Trump fuels hopes that both sides are able to reach a general agreement before the deadline to avoid the further escalation of the trade war. China's latest move to allow the rating agency S&P to enter China's credit market is likely to build goodwill and serve as a starting point for China's structural reform. However, uncertainty remains as two of the three foundational issues including China's long term structural reform and enforcement are not addressed. We think China's state planning industry policy is likely to be the focus of the upcoming negotiations.

China's official PMI remained in the contraction territory in January. PMI for large corporation recovered strongly to 51.3 from 50.1 while PMI for medium and small corporation weakened further, in line with the sharp decline of Caixin PMI. The jump of PMI for large corporation by 1.2 shows that China's easing policy may have taken effect as big companies tend to feel the impact first.

China stepped up its policy support further. China's economic planning agency National Development and Reform Commission together with other nine Ministries and agencies unveiled the new six measures to support China's domestic demand. On local government bond issuance, China lowered the funding costs for local governments to allow the minimum spread to be lowered to 25bps from 40bps. Demand for local government bonds eased slightly with over subscription ratio fell from 40-50 times to below 20 times, but sufficient to support the local government issuance.

In Hong Kong, the economic indicators for last Dec were mixed. First, exports and imports continued to fall by 5.8% yoy and 7% yoy respectively amid the end of front-loading trade activities. Second, retail sales value merely grew by 0.1% yoy on concerns about trade war and global economic slowdown. Third, loans for use in HK excluding trade finance grew by 6.5% yoy, owing to US-China trade truce and the acceleration of new home launches in 4Q18. We expect GDP growth will moderate to 2.5% yoy in 4Q18. Elsewhere, HKD loan-to-deposit ratio rose to the highest since Jun 2005 at 86.9% as HKD loans rose faster than HKD deposits in December. During the same month, the percentage share of HKD time deposits in total HKD deposits rose to the highest since Mar 2009 at 41.8%. Taken all together, it points out that the funding pressure mounted on the banking system. On a positive note, HK's capital outflow risks reduced with China unveiling more stimulus measures and the Fed shifting to a dovish stance. As such, the upside risks to either HIBOR or HKD time deposit rates have eased. Besides, we expect total loans growth to slow down amid the faltering global growth, the prolonged trade war and the shifting of Mainland companies' loan demand back to onshore market. As such, the funding pressure on the banking system may not grow much further. Still, whether the banking system will raise prime rate in 2019 may hinge on the Fed's rate hike pace and the change in aggregate balance. After Chinese New Year, we expect HKD liquidity to ease again in the absence of large IPOs and seasonality. 1M HIBOR may fall below 1% while USDHKD may grind slowly to 7.85 and prompt further liquidity withdrawal by the HKMA.

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The US and China concluded the latest trade talk with limited details except that China was reported to buy additional 5 million tons of soybean on top of previous proposed daily purchase of 5 million tons.
Before the trade talk, China approved the request by the rating agency S&P to enter China's domestic credit market to rate China's domestic bonds.
The US chief trade negotiator Lightnzer said the "substantial progress" achieved while President Trump's twitter also looks upbeat. However, lifting tariff was not part of the talks at the moment.
China proposed the meeting between President Trump and President Xi in late Feb to seal the deal.

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There are three foundational issues for the upcoming US-China trade talk in February as well as years ahead including China's immediate reform to delay the planned tariff hike on 2 March, China's long term structural reform to re-engage the US and enforcement of trade deal.
The latest move to allow S&P to enter China's credit market is likely to build goodwill and serve as a starting point for China's structural reform. We think both sides may reach a general agreement before the deadline to avoid the further escalation of the trade war. However, uncertainty remains as the three foundational issues have not been fully addressed.
According to the report from the Wall Street Journal, China is reluctant to release the list of subsidies to Chinese domestic firms from both central government and local government. We think China's state planning industry policy is likely to be the focus of the upcoming negotiations.

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▪ China's economic planning agency National Development and Reform Commission together with other nine Ministries and agencies unveiled the new six measures to support China's domestic demand. The measures will cover areas including car sales, improving work for old estates to meet the demand from the aging population, e-commerce and tourism spending in rural areas, green and smart home appliance, promoting Chinese traditional consumer brands and speeding up the issuance of 5G license etc.	▪ The deceleration of retail sales in 2018 was mainly the result of the decline of car sales, which fell by 2.8% first decline since 1990s. Given car sales is the largest component for China's retail sales, accounting for 28.6% in 2018 and China's car ownership is still low as compared to G3 economies, subsidies to boost car sales remains the most effective measure for China to support the retail sales growth. ▪ On details, China plans to loosen the restrictions on the second hand auto sales as well as granting subsidies to smaller passenger cars with engine size 1.6L and below in rural areas. ▪ This may stabilize the car sales, which will in turn provide the floor for retail sales growth.
▪ China lowered the premier paid by local governments for bond issuance from previously minimum 40bps above equivalent central government bond to a range of 25bps to 40bps.	▪ Back in August 2018, China set an unofficial guidance on the minimum 40ps spread for local government bonds to attract more investment demand. Given the strong demand for local government bonds recently, the loosening of minimum spread is helpful for local governments to lower their funding costs. ▪ Demand for local government bonds following the fine-tune of minimum spread eased slightly with over subscription ratio fell from 40-50 times to below 20 times.
▪ Guangdong Development and Reform Commission announced that they will focus on six aspects when promoting the development of the Greater Bay Area in 2019.	▪ Those aspects include conducting the plans to develop the bay area, proactively developing soft infrastructure to facilitate the cooperation across the bay area, building an international technology innovation center with Hong Kong and Macau, accelerating the construction of infrastructure connecting the bay area, promoting the collaboration between HK, Guangdong and Macau in terms of livelihood and culture, as well as setting up a platform to support the Belt and Road Initiative. ▪ During 2018, we note that the Greater Bay Area took a hit by China's economic slowdown and external shocks as it specifies in advanced manufacturing and high-tech which rely highly on internal and external demand. HK's trade activities contracted in tandem with Mainland China's in December while the exports growth for Jan-Nov 2018 for the nine cities in Guangdong was slower than that for China as a whole. On the other hand, Shenzhen, as the technology hub of China, suffered from the conflicts between US-China in terms of technology transfer. Against this backdrop, the Greater Bay Area may have to increase the collaboration within the area, in an effort to improve the productivity and the competitiveness of the area.

Key Economic News

Facts	OCBC Opinions
▪ China's industrial profit fell by 1.9% yoy in December, the weakest growth since December 2015.	▪ The decline of industrial profit was mainly due to the decline of PPI, which led to slower profit growth for the upstream industries such as commodity and chemical etc. However, it is good for the downstream industries. For example, profitability for garment industry improved due to lower raw material costs. Given China's PPI is expected to remain weak in the coming months, China's industry profit is likely to remain weak into 2019.

	▪ On the positive note, the industrial profit for private owned companies improved with total profit growth reaccelerated to 11.9% in 2018 from 10% in the first eleven months of 2018.
▪ China's official PMI rebounded slightly in January to 49.5 from 49.4 in December 2017. ▪ PMI for large corporation recovered strongly to 51.3 from 50.1 while PMI for medium and small corporation softened further to 47.2 and 47.3 respectively.	▪ Both supply and demand stabilized in January. On supply side, production increased by 0.1 to 50.9. On demand side, new export orders rebounded by 0.3 to 46.9 although new orders continued to soften to 49.6 down from 49.7. ▪ On price level, the purchasing price index also recovered to 46.3 from 44.8 due to rebound of commodity prices in January. The recovery of the purchasing price index may narrow the sequential decline of PPI. However, on year-on-year basis, we expect China's PPI to decelerate further to around 0.2% in January. ▪ The jump of PMI for large corporation by 1.2 shows that China's easing policy may have taken effect as big companies tend to feel the impact first.
▪ HK's trade data surprised to the downside with exports and imports down by 5.8% yoy and 7% yoy respectively in December 2018. This is in tandem with the contraction of China's trade activities. Due to the deeper decrease in imports, trade deficit widened from HK$45 billion to HK$51.2 billion.	▪ Zooming in, exports to Mainland China and the US dropped by 8.7% yoy and 0.7% yoy respectively while imports from Mainland China slid by 4.2% yoy as well. This points out that the front-loading activities of Mainland China and the US came to an end. Though the US and China agreed on a 90-day trade war ceasefire, the new tariff on both China and the US remained in effect and would continue to weigh down HK's trade activities (exports and imports with Mainland China and the US took up 57% of HK's total exports and imports). ▪ Worse still, exports to India, Japan and Vietnam tumbled by 35.9% yoy, 3.6% yoy and 15.7% yoy respectively. Imports from Mainland China, Taiwan, Japan and South Korea dropped 4.2% yoy, 29.6% yoy, 12.7% yoy and 25.4% yoy respectively. This suggests that domestic and external demand has been weakening due to global economic slowdown and the lingering uncertainties from trade war. ▪ Moving ahead, we expect trade activities will continue to slow down and even see deeper contraction should trade war between the US and China become technology war.
▪ HK's retail sales value grew marginally by 0.1% yoy in December and increased by 8.8% yoy in 2018 as a whole.	▪ Internally, we note that domestic demand has been weakening due to the correction in both stock market and property market. Local economic slowdown and external uncertainties also clouded salary prospects and dampened consumer sentiment. As a result, the growth in the sales of food, alcoholic drinks and tobacco slowed down from 1.9% yoy to 1% yoy while the sales of consumer durable goods dropped for the second consecutive month by 9.3% yoy. ▪ Externally, though the recent infrastructure improvement helped to bolster inbound tourism, visitor spending remained muted due to global economic slowdown, a strong HKD and the lingering uncertainty about US-China trade war. Consequently, the sales of jewelry, clock and watches fell for the second consecutive month by 4.9% yoy. ▪ Moving into early 2019, three factors including RMB rally, eased trade tensions and China's stimulus measures may lend some support to the retail sector. Adding on Lunar New Year effect, January's retail sales growth might have re-accelerated. ▪ Nevertheless, in the medium term, we expect RMB's rally to be unsustainable and the trader war risks to remain intact. As such, the outlook of the retail sector remains subdued. Adding on high base effect, we expect retail sales to fall by around 2% this year.

	If this is the case, retail property market is likely to slow down as well.
▪ HK's total loans and advances expanded by 4.4% yoy in December, mainly led by the 5.4% yoy growth of loans for use in HK which took up 66% of total loans and advances.	▪ Zooming in, due to trade war escalation, trade finance shrank for the fourth consecutive month by 7.6% yoy. In contrast, other loans for use in HK excluding trade finance grew by 6.5% yoy. According to the HKMA, loans to building, construction, property development and investment, residential mortgage loans, and loans to financial concerns led the rebound of loans for use in HK in 4Q18. This might be partially attributed to the retreat of local interest rates during October and November, the US-China trade truce from December, as well as the property developers' strategy to accelerate housing completion and new home sales in 4Q18. ▪ On the other hand, the growth of loans for use outside of HK decelerated further to 2.1% yoy in December, the weakest since November 2016. This was mainly due to a weaker RMB and China's easing monetary policy. ▪ Moving into 2019, trade finance will likely remain suppressed as trade war continues to materialize. With the PBOC further easing the monetary policy, we expect loans for use outside of HK to grow at a slower pace this year. On a positive note, local loan demand could remain resilient in the near term as business and investor sentiments improved slightly on dovish Fed, US-China trade truce and China's stimulus measures. ▪ In the medium term, whether local loans excluding trade finance could sustain solid growth will depend on the major central banks' stance, the effect of China's stimulus as well as the development of trade war. At this juncture, we expect total loans and advances to grow but at a slower pace this year.
▪ HKD loan-to-deposit ratio rose to the highest since Jun 2005 at 86.9% as HKD loans rose by 1.1% mom while HKD deposits increased at a slower pace by 0.3% mom in December.	▪ HKD demand deposits slid for the fourth straight month by 6.0% yoy to HK$1.1 trillion while HKD savings deposits dropped for the sixth consecutive month by 8.5% yoy to HK$2.8 trillion. This could be attributed to the stock market rout during late 2018 and the increased attractiveness of higher-yielding time deposits. ▪ HKD time deposits (+24.9% yoy) saw double-digit annual growth for seventh month in a row. As a result, the percentage share of HKD time deposits in total HKD deposits rose to the highest since Mar 2009 at 41.8%. This combined with the high HKD loan-to-deposit ratio points out that the funding pressure mounted on the banking system. ▪ On a positive note, HK's capital outflow risks reduced with China unveiling more stimulus measures and the Fed shifting to a dovish stance. As such, the upside risks to either HIBOR or HKD time deposit rates have eased. Besides, we expect total loans growth to slow down this year. Therefore, the funding pressure on the banking system may not grow much further.
▪ HK's RMB deposits increased by 10% yoy in RMB615 billion in December 2018.	▪ The strong growth despite RMB's depreciation could be attributed to the increased capital inflows from HK to Mainland China as well as the relatively high rates of RMB deposits. This year, the inclusion of A-share and China's bonds into global index may help to lure more capital inflows to Mainland China. As such, RMB deposits may find some support. However, given the policy divergence between the Fed and the PBOC, the attractiveness of RMB deposits in HK may diminish gradually. All in all, we expect RMB deposits to oscillate around 600-610 billion this year.

▪ HK's exchange funds lost HK$30.6 billion in 4Q 2018 due to global stock rout. Though exchange funds gained HK$13.9 billion in 2018 as a whole, the gain was 94.7% lower than that in 2017.	▪ During 2018, due to the strong performance of the broad dollar, the exchange funds exhibited foreign exchange losses of HK$9 billion. Besides, local and overseas stock investments respectively recorded losses of HK$20.7 billion and HK$38.3 billion, mainly due to the notable equity sell-off on the escalated trade war and the tightened global liquidity. On a positive note, owing to the increasing concerns about global economic outlook, global bond markets rebounded in late 2018 and the HKMA's strategy to shorten the duration has supported the bond investments to gain HK$57.4 billion. ▪ Moving forward, the performance of exchange funds this year may be mixed. First, as the dollar is unlikely to gain as much as last year, foreign exchange may recover last year's losses. Second, global equity markets rebounded lately thanks to dovish central banks, eased trade tensions and China's stimulus measures. This indicates that local and overseas stock investments could register some gains in 1Q19. However, the full-year performance of global stock markets could turn out to be subdued given the possible underestimate of Fed rate hikes, the persistent slowdown of global growth and the lingering uncertainty from trade war. Third, in terms of bond investments, we expect the bond markets to remain elevated on the back of dovish central banks and concerns about global economic slowdown. In conclusion, exchange funds may continue to show moderate gain this year. As such, the sizeable exchange fund (currently HK$4.06 trillion as at the end of December 2018, much stronger than the HK$0.91 trillion as of end-1998) could allow the HKMA to well maintain the linked exchange rate system.
▪ Macau's gross gaming revenue dropped for the first time since July 2016 by 5% yoy to MOP24.9 billion in January 2019.	▪ As the gaming demand normally weakens ahead of Chinese New year, January's decline might be partially attributed to seasonality. ▪ On a positive note, in 4Q18, the percentage share of mass-market gaming revenue in gross gaming revenue rose for the fifth consecutive quarter to the highest since 3Q16 at 41.7%. This reflects that casino operators have gradually diversified the gaming sector from over-reliance on VIP business. As such, the shock from China's slowdown and policy risks may be milder than before while gross gaming revenue may still see positive growth this year. ▪ However, the growth is expected to decelerate from 14% in 2018 to 2%-5% in 2019. Specifically, though the latest infrastructure improvement did help to lure more visitors to the gambling hub, it did little to bolster the gaming sector by mainly bringing in low-end same-day tourists. Besides, the faltering global growth and worsening trade outlook may weigh down visitor spending and gaming demand.
▪ Macau's unemployment rate held static at a nearly four-year low of 1.7% in 4Q 2018. ▪ The total employed population increased to the highest since late 2016 and printed at 388000 while the labour force participation rate rebounded to 70.9%.	▪ Taken all together, it reflects a still resilient labour market of Macau. Nevertheless, the employment situation was mixed across major industries. On the back of infrastructure improvement, China's stimulus and a dovish Fed, Macau's buoyant tourism and gaming activities supported the employment of gaming industry (+0.4% mom), retail industry (2.1% mom) as well as hotels & restaurants industry (+0.54% mom). On the flip side, with most of the mega projects completed successively, the demand for construction workers decreased and

	resulted in a 1.1% mom drop in the employed population of construction industry. ▪ In the near term, we expect the eased external headwinds will continue to buoy hiring sentiments. However, the lingering uncertainties from US-China trade war and global monetary tightening could still weigh on Macau's medium-term outlook. Therefore, we expect unemployment rate will retrace higher to 1.8% or above in the medium term.

RMB	
Facts	**OCBC Opinions**
▪ RMB gave up most of its weekly gain on Friday with the USDCNY bid up to 6.74-75 range after failing to stand firm below 6.7. Spot RMB index also retreated to below 94.	▪ The correction of RMB on Friday was mainly due to profit taking ahead of Chinese New Year holiday despite positive headlines from the US-China trade. We expect the pair to stay in 6.7-6.8 range in the next two weeks.

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