Highlights

China's bond market bull run may pause after Premier Li Keqiang rarely warned against the potential risk from the arbitrage activities from the bill financing. Against the backdrop of extremely flushed liquidity, the warning may keep the speculation in check. We expect China's rates market to consolidate in the near term. In addition, PBoC reported a 31bps decline of weighed average loan rate in the last quarter of 2018 in its 4Q monetary policy report. Together with the easing monetary condition, we think there is no urgency for PBoC to cut benchmark interest rate in the near term.

On trade talk, a deadline to raise tariff on Chinese goods will be extended until Trump's meeting with President Xi. As both Presidents said significant progress has been made, the chance for the US and China to reach a deal is getting higher. However, the key to medium term stability hinges on two areas including agreement on China's structural reforms and the enforcement of trade deals.

RMB continued to benefit from the positive headline from the trade talk. RMB index recovered to above 94.85, recouping most of the losses since the start of trade war in July 2018. US Treasury Secretary Mnuchin's comments that US asked for RMB's stability may fuel further excitement. The probability for RMB to break 6.70 is getting higher as one of the key constraints US-China rate differential may diminish in the near term should China's bond market bull run pause.

Elsewhere, China unveiled the details on its Greater Bay initiative. The Greater Bay Area development plan will be part of a broader framework for China to boost the innovation against the backdrop of a diminishing demographic dividend.

In **Hong Kong,** USDHKD spot rose to as high as 7.8494 last week on the back of very flushed liquidity. 1M HIBOR and 3M HIBOR dropped respectively from 1.02% and 1.72% on 15th Feb to 0.96% and 1.57% on 22nd Feb. We expect 1M HIBOR will hover below 1% and 3M HIBOR will fall towards 1.5% in the coming sessions. Apart from the upcoming month-end effect, we barely see any liquidity squeeze events around the corner. This means that the persistently wide USD-HKD yield differential could continue to support carry trade and keep HKD close to the weak end of the currency peg. Nevertheless, the pair's move to 7.8500 may be slow and gradual. With aggregate balance shrinking by over 50% last year, the volatility of both HIBOR and HKD has increased notably. As such, despite positive carry, short HKD traders tend to be cautious and keep their short positions light when USDHKD spot stands near 7.8500. In other words, we may have to wait for another while to see the pair reach 7.8500. Elsewhere, overseas investors have been pre-positioning for the expected increase in the weighting of A-shares in the MSCI index. Adding on the increasing appeal of RMB assets amid stronger RMB, the month-to-date northbound equity inflows reached RMB51.4 billion, just a tad lower than last month's record high of RMB60.69 billion. The continuous capital flows from HK to China may also weigh on the HKD in the near term. Finally, the long-awaited Greater Bay Area Plan points out the promotion of connect schemes for cross-border financial markets. We expect this will help Hong Kong benefit from the increasing needs of wealth management of high-net-worth residents in the bay area as well as the rising demand of the fast-growing companies for offshore financing and overseas business expansion.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ PBoC published its first 4Q monetary policy report last week. Weighed average loan rate fell to 5.63% in December, down by 31bps from September's level. ▪ PBoC said in one of its columns that there is no need for China to pursue quantitative easing as there is still enough room for the current monetary policy mechanism. ▪ China's financial market continued to develop at a rapid pace. Daily trading volume for interbank bonds surged by 46% to CNY598.2 billion in 2018 while annual trading volume for IRS jumped by 49.2% to CNY21.49 trillion. Bond issuance increased by 7.5% to CNY43.1 trillion with total outstanding of China's bond market rose by 15.1% to CNY86 trillion. ▪ On currency, total RMB spot trading volume	▪ In addition to the significant decline of weighed average funding costs, loans priced below benchmark interest rate increased to 16.27% up from 9.59% in July, signalling easing monetary condition. The latest data show that monetary easing is taking effect in the last quarter of 2018. The 31bps decline of average funding costs is equivalent to one rate cut, therefore there is no urgency for PBoC to cut benchmark interest rate at the current stage in my view. ▪ However, given China's monetary policy framework is moving towards a big country model, meaning that when domestic balance colluded with the external balance, domestic balance will take the priority, this suggest that China's interest rate policy will not be constrained to external factor such as weaker Yuan should China's economy slow down more than expected. ▪ Overall, we think the chance of interest rate cut may not be ruled out. Nevertheless, China will try other options before eventually moving to the interest rate cut.

increased by 19.3% to US$7.6 trillion while total swap transaction increased by 22.7% to US$16.4 trillion.	
	▪
▪ China's Premier Li Keqiang reiterated in the State Council meeting that China's prudent monetary policy stance has not changed and will not change. China will also not flood the economy with excessive liquidity. In a rare case, China's central bank and State Council warned against the arbitrage activity due to surge in short term bill financing though the PBoC said the arbi activities only accounted for a small percentage of total lending.	▪ Although Premier Li's reassurance on prudent monetary policy is not new, the rare warning against the arbitrage against the backdrop of extremely flushed interbank liquidity may keep the speculation in check. We expect China's rates market to consolidate in the near term and 10-year government bond yield is unlikely to test 3% without more catalysts.
▪ PBoC conducted its first Central Bank Swap (CBS) on 20 Feb to support the issuance of perpetual bond by financial institutions. The 4.5% Bank of China perpetual bond can be swapped to 1-year PBoC bill with coupon at 2.45%. The cost of CBS was set at 0.25% currently.	▪ As mentioned clearly by PBoC officials that the CBS is not QE, as such, the PBoC will not pay interest for its bill and the bill will be automatically cancelled once expires.
▪ On trade talk, both sides extended the negotiations by two days last week through Sunday, President Trump said he will extend a deadline until he can meet Chinese President Xi.	▪ As both Presidents said significant progress has been made, the chance for the US and China to reach a deal is getting higher. However, the key to medium term stability hinges on two areas including agreement on China's structural reforms and the enforcement of trade deals.
▪ China unveiled the details on its Greater Bay initiative.	▪ According to the plan, in the longer term, Hong Kong will enhance and improve its role as an international center of finance, shipping, trade and aviation while Shenzhen will become a city of innovation and creativity. Besides, Macau will develop an international recreation and leisure center while Guangzhou will be a center connecting global commerce and be a transportation junction linking to the bay area's major trading partners. As these are the long-term development goals, we expect the plan will do little to revive the area's growth at this juncture, especially against the backdrop of global economic slowdown and lingering trade war risks. ▪ On a positive note, the plan points out the bay area's support to a slew of infrastructure projects, including the construction of the third runway of HK airport and the expansion of the airports of Guangzhou and Shenzhen. Infrastructure investment may help to cushion the growth of the bay area in the near term and pave the way for the expectedly free flow of human resources, information, capital, etc. across the area in the longer term. ▪ Elsewhere, the plan points out the promotion of connect schemes for cross-border financial markets. Specifically, cross-border use of the RMB will be encouraged with the scale and the area for RMB's cross-border usage to be expanded. Companies in the bay area will be allowed to issue cross-border RMB-denominated bonds. Cross-border investment by individual and institutional investors of the bay area will be expanded to include more financial products including funds, insurance and so on. All in all, we expect this will help Hong Kong benefit from the increasing needs of wealth management of high-net-worth residents in the bay area as well as the rising demand of the fast-growing companies for offshore financing and overseas business

	expansion. ▪ The Greater Bay Area development plan will be part of a broader framework for China to boost the innovation against the backdrop of a diminishing demographic dividend. As the idea of the GBA was floated to the public in 2017 before the trade war, we think the trade war is unlikely to derail its development. However, indirectly the GBA may help counter the negative impact of the trade war. For example, China has silenced the "Made in China 2025" initiative due to the pressure from the trade war. Part of the initiative could be subsumed under the GBA initiative to continue to boost China's innovation and high-tech competitiveness. ▪ In terms of the impact on Singapore, the reinforcement of Hong Kong's role as a global financial centre and offshore Yuan hub may pose some immediate challenges to Singapore. Clearly, Hong Kong will be the first to benefit from China's opening up and financial reform. However, in the medium term, we think Singapore can also benefit from the GBA initiative as the key word for the GBA initiative is "connectivity". GBA is a good test bed for broader connectivity between China and South East Asia. Singapore can play an important role in facilitating the connection between China and the region. In the near term, Singapore companies can benefit via participating in the GBA directly.
▪ USDHKD spot rose to as high as 7.8494 last week on the back of very flushed liquidity. 1M HIBOR and 3M HIBOR dropped respectively from 1.02% and 1.72% on 15th Feb to 0.96% and 1.57% on 22nd Feb. We expect 1M HIBOR will hover below 1% and 3M HIBOR will fall towards 1.5% in the coming sessions.	▪ Apart from the upcoming month-end effect, we barely see any liquidity squeeze events around the corner. This means that the persistently wide USD-HKD yield differential could continue to support carry trade and keep HKD close to the weak end of the currency peg. Nevertheless, the pair's move to 7.8500 may be slow and gradual. With aggregate balance shrinking by over 50% last year, the volatility of both HIBOR and HKD has increased notably. As such, despite positive carry, short HKD traders tend to be cautious and keep their short positions light when USDHKD spot stands near 7.8500. Last year, before USDHKD spot touched 7.8500 and triggered HKMA's intervention on 14th Aug (first time since last May), the pair had closed above 7.8490 for eight consecutive days. Lately, the USDHKD spot only closed over 7.8490 on 20th February. If history repeats itself, we may have to wait for another while to see the pair reach 7.8500. ▪ Elsewhere, the worse-than-expected earnings result of HK-listed companies have deterred Chinese investors with southbound equity flow marking outflows for the third consecutive day on 21st February. On the flipside, overseas investors have been pre-positioning for the expected increase in the weighting of A-shares in the MSCI index. Adding on the increasing appeal of RMB assets amid stronger RMB, northbound equity flow registered inflows for the eighteenth consecutive month on 22nd February and the month-to-date inflows reached RMB51.4 billion, just a tad lower than last month's record high of RMB60.69 billion. The continuous capital flows from HK to China may also weigh on the HKD in the near term.

Key Economic News	
Facts	**OCBC Opinions**

▪ Chinese banks net sold US$12.1 billion foreign currencies in January, the first surplus since the outbreak of trade war in July 2018. ▪ Meanwhile, the willingness to sell foreign currencies improved to 63.4% in January from 59.9% in December.	▪ The return of capital inflows was mainly the result of stable RMB. Meanwhile, the sharp decline of hedging costs due to flushed RMB liquidity in both onshore and offshore market also make RMB assets more appealing to foreign investors despite the decline of yields. This may attract more capital inflows which may in turn support China's FX reserve.
▪ HK's unemployment rate kept static at an over two-decade low of 2.8% during the three months through January 2019.	▪ Delving into details, with inbound tourism gaining further momentum from the recent infrastructure improvement, the unemployment rate of retail sector dropped further from 3.6% to decade-low of 3.5%. Besides, the unemployment rate of trade sector edged down from 2.2% to decade-low of 2%. Despite that, we doubt the sustainability of the rosy job data given the faltering economic growth. Specifically, in spite of the positive headlines about recent trade talks, neither US nor China is likely to remove the existing tariff. As such, the worsening outlook of the trade sector is expected to weigh on the sector's employment. Besides, against the backdrop of global economic slowdown and the lingering trade war risks, local consumption and tourist spending are likely to remain subdued and cloud the jobs outlook of tourism-related sector. Sluggish economic outlook of HK may also hit overall hiring sentiments. Overall speaking, we expect the unemployment rate will climb to 2.9% in the near term.

RMB

Facts	OCBC Opinions
▪ RMB extended its gain against both dollar and its major trading partners last week. RMB index recovered to above 94.85, recouping most of the losses since the start of trade war in July 2018. Meanwhile, the USDCNY tested 6.70 handle again on the back of hopes on trade talk.	▪ RMB's recover against its major trading partners mainly benefited from two factors including trade talk hopes and capital inflows. The comments from the US Treasury Secretary Mnuchin that currency pact to ask China to keep Yuan stable as part of the agreement may fuel more speculation on RMB. ▪ We think the probability for Yuan to break the psychological 6.70 this week is getting higher not only because of US's demand for RMB's stability but also because of the pause of China's bond bull run. After Premier Li's comments on arbitrage, we think the speculation on 10-year bond yield to go down to 3% may diminish in the near term. This may alleviate the pressure from the policy divergence on RMB in the near term.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com