Highlights

The Chinese economy decelerated to 6.6% yoy in 2018 from 6.8% yoy in 2017, in line with market expectation. From expenditure method perspective, contribution from consumption to growth increased further in 2018 accounting for about 76% of growth, highest in record. From industrial perspective, tertiary industry accounted for about 59.7% of GDP with information technology and software outperforming up by 22.84% yoy. However, the contribution from property sector to Chinese growth fell significantly to 3.8% in 2018.

In the rates market, China's government bond prices retreated with 10-year government bond yield edged up by 3.9bps to 3.144%. The jittery was mainly due to three reasons including tighter short end liquidity, supply concerns and rising expectation on earlier than expected recovery of Chinese economy.

PBoC withdrew the short end liquidity via the suspension of open market operation but instead injecting long term liquidity via the TMLF and revised dynamic assessment on targeted reserve requirement ratio. On issuance side, the Chinese local governments have issued close to CNY130 billion local government bond year to date with about CNY300 billion more in the pipeline this week. Nevertheless, the strong demand for local government bonds (40-50 times oversubscription on average) thanks to easing monetary policy shows that supply concern is unlikely to weigh down on bond sentiment.

The key driver to rates in the near term could well hinge on expectation on growth. PBoC launched a new facility, Central Bank Bills Swap (CBS), to support banks' demand for the issuance of perpetual bonds, which will help replenish banks' capital to allow banks increase their funding support to the real economy. The new initiative to solve the breakdown of funding transmission mechanism and the surge of issuance of local government bonds gave markets hope that the Chinese economy may find the bottom soon.

For this week, the Chinese delegation led by Vice Premier Liu He will visit the US on 30 and 31 January. Market will closely watch out for the development. Any surprise could move the market.

In **Hong Kong**, HKD liquidity remained extremely flushed with 1M HIBOR and 3M HIBOR making another leg lower. Specifically, though the aggregate balance shrank by over 50% from last April to HK$76.5 billion, it is much higher than the daily average of HK$7 billion during 2000 to 2008. Besides, the outstanding exchange fund bills and notes amounted to HK$1.06 trillion as of 24th Jan 2019, up significantly from HK$0.16 trillion as of end-2008. Furthermore, loan demand has been weakening due to China's easing policy and concerns about economic outlook. As such, HKD liquidity is indeed very ample. Due to the flushed liquidity, USD-HKD yield differential has been widening with 1M LIBOR-HIBOR spread widening to the largest since 2007 at 139bps. This may make carry trade persistently attractive. With carry trade remaining active and equity flow continuing to see net outflows amid muted economic outlook and trade war concerns, USDHKD spot will likely grind gradually to 7.85 and prompt further liquidity withdrawal by the HKMA. In other words, the extremely flushed HKD liquidity may not sustain in the long term. However, due to a dovish major central banks, China's supportive measures and the eased trade tensions, equity outflow risk is expected to be manageable. Also, when USDHKD gets closer to 7.8500, carry trade will likely become more cautious. As such, any liquidity withdrawal caused by carry trade will likely be moderate. In conclusion, HKD liquidity is expected to shrink this year but at a gradual pace. If this is the case, HIBOR and HKD may continue to see two-way volatility this year. We expect 1M HIBOR to rebound slightly near month-end and Chinese New Year and move down again towards 1% in the aftermath.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China's central bank introduced a new facility, Central Bank Bills Swap (CBS), to provide liquidity support to the issuance of perpetual bond by the Chinese banks. ▪ Qualified banks are allowed to swap the perpetual bond they hold with the PBoC bills. The bills are not allowed for trade and repo but can be used as collateral. The swap will be less than 3 years in principle. ▪ In addition, PBoC also expanded the scope of collateral for MLF, TMLF and re-lending to include the perpetual bond. ▪ According to PBoC, the impact of the swap on	▪ One of the key challenges faced by the PBoC in 2018 is the breakdown of transmission mechanism from the money market to the real economy to support the funding demand from the small companies. One of the factors behind the transmission mechanism is the capital constraints. As a result of China's de-leveraging campaign, the funding demand has been brought back to on-balance sheet from off-balance sheet. However, the room for lending spree has been capped by bank's capital, which constraints banks' capability to support the real economy. ▪ Against this backdrop, China has given the green light to banks to replenish their capital via the issuance of perpetual bonds. The latest introduction of CBS is a new incentive designed by the central bank to give banks benefit to invest in the perpetual

liquidity is neutral as the facility will not affect the base money creation. ▪ Meanwhile, China's banking and insurance regulators also gave the green light to insurance companies to buy perpetual bond.	bond via liquidity support. ▪ Clearly, the CBS is different from the QE as claimed by some investors as it will not boost the central bank's balance sheet directly. And the perpetual bond, which participates in the swap with the central bank, will sit in the commercial bank's balance sheet. ▪ Nevertheless, there is one technical issue remains to be addressed that how PBoC book the PBoC bill. As PBoC has not issued the PBoC bill since 2013, there has been no outstanding of PBoC bill. The swap program means that PBoC needs to issue new bill for the swap.
▪ The Chinese local governments have issued close to CNY130 billion local government bond year to date. The demand for those bonds is strong with most of bonds were oversubscribed by more than 40 times. ▪ Close to additional CNY300 billion local government bond is likely to be in the pipeline for issuance ahead of Chinese New Year holiday.	▪ The issuance of local government bonds have sped up in January after the regulator brought forward the quota. Thanks to easing monetary policy, the recent strong demand for local government bonds show that the increasing supply is unlikely to weigh down on bond sentiment. ▪ From the economic perspective, the rising issuance is likely to support local investment which may in turn support local growth.
▪ PBoC suspended open market operation last week for five consecutive trading days due to relatively flush liquidity. Meanwhile, PBoC conducted its first TMLF operation injecting CNY257.5 billion into the system. ▪ PBoC also announced it has conducted the dynamic assessment of targeted reserve requirement ratio to support inclusive finance. Given more financial institutions have met the criteria for lower RRR, the PBoC expects the new assessment will unlock about CNY250 billion long term liquidity to the system.	▪ China's short end money market rates increased last week as PBoC withdrew the short-term liquidity via the suspension of open market operation. However, PBoC injected the long-term liquidity via the TMLF and more targeted RRR cut following the dynamic assessment. ▪ We think PBoC will continue to swap the short end liquidity with long end liquidity to support China's initiative to boost lending to the small and private owned companies.
▪ On US-China trade talk, the US Commerce Minister Ross downplayed the market expectation last week that US and China are long way from getting a resolution as trade is a very complicated issue. ▪ Nevertheless, he still sees a fair chance to get to a deal eventually.	▪ The Chinese delegation led by Vice Premier Liu He will visit the US on 30 and 31 January. Market will closely watch out for the development. Any surprise could move the market.
▪ 1M HIBOR and 3M HIBOR made another leg lower to 1.12% (weakest since last Nov) and 1.76% (weakest since last May) respectively. This indicates extremely flushed HKD liquidity.	▪ In terms of HKD liquidity, the aggregate balance (HK$76.5 billion), though shrank by over 50% from last April, is much higher than the daily average of HK$7 billion during 2000 to 2008. Besides, the outstanding exchange fund bills and notes amounted to HK$1.06 trillion as of 24th Jan 2019, up significantly from HK$0.16 trillion as of end-2008. Furthermore, loan demand has been weakening due to China's easing policy and concerns about economic outlook. As such, HKD liquidity is indeed very ample. ▪ Due to the flushed liquidity, USD-HKD yield differential has been widening with 1M LIBOR-HIBOR spread widening to the largest since 2007 at 139bps. This may make carry trade (short HKD for higher-yielding USD) persistently attractive. With carry trade remaining active and equity flow continuing to see net outflows amid muted economic outlook and trade war concerns, USDHKD spot will likely grind gradually to 7.85 and prompt further liquidity withdrawal by the HKMA. In other words, the extremely flushed HKD liquidity may not sustain in the long term. ▪ However, due to a dovish major central banks, China's supportive measures and the eased trade tensions, equity outflow risk is expected to be manageable. Also, when USDHKD

	gets closer to 7.8500, carry trade will likely become more cautious in case the HKD rallies sharply on any notable reduction in aggregate balance. As such, any liquidity withdrawal caused by carry trade will likely be moderate. In conclusion, HKD liquidity is expected to shrink this year but at a gradual pace. If this is the case, HIBOR and HKD may continue to see two-way volatility this year. We expect 1M HIBOR to rebound slightly near month-end and Chinese New Year and move down again towards 1% in the aftermath.
▪ Hong Kong's residential property market has been ranked the world's least affordable for the 9th consecutive year with the housing price to median income ratio rising from 19.4 in 2017 to 20.9 in 2018, according to the Demographia International Housing Affordability Study.	▪ On a positive note, the overheated housing market has started to cool down. Last week, Hong Kong's largest property developer bid a plot of residential land with HK$11.26 billion, or HK$17,360 per square foot. The price is within expectation, meaning that the property developer is confident but not too optimistic about the property market's outlook. Besides, the tender only attracted six bids from HK's developers, suggesting that property market sentiment is less upbeat than before. Due to the prospects of increasing supply (government promised to increase public housing supply and estimates that some 93,000 private units may be available in the coming three to four years), higher borrowing costs and the lingering uncertainty about US-China trade war, property market growth is likely to slow down further this year. ▪ However, the prices of the residential lands have been much higher than years ago. Adding on the increasing costs of construction, it indicates that the medium to long term downside for the private home prices could be limited.

Key Economic News

Facts	OCBC Opinions
▪ The Chinese economy decelerated further to 6.4% yoy in 4Q. For the whole year of 2018, the economy slowed down to 6.6% from 6.8%, in line with market expectation. ▪ Industrial production rebounded slightly to 5.7% yoy in December from 5.4% yoy. ▪ Retail sales also rebounded slightly to 8.2% yoy from 8.1% though car sales fell by 8.5% yoy in December. ▪ Fixed asset investment growth remained intact at 5.9%yoy.	▪ From expenditure method perspective, contribution from consumption to growth increased further in 2018. Among 6.6% GDP growth, 5% came from consumption, highest in record. Capital formation remained relatively stable, however, net exports of goods and services dragged down the GDP growth by 0.6%. ▪ From industrial perspective, tertiary industry accounted for about 59.7% of GDP in 2018, up from 58.8% in 2017. The pace of growth of major industries slowed in 2018 except the information technology and software, which increased by 22.84% yoy in nominal term, up from 20.56% in 2017. However, as information technology only accounted for 3.6% of total GDP, the strong growth in this sector failed to stop the economy from decelerating. ▪ The contribution from property sector to Chinese growth fell significantly to 3.8% in 2018, down from 6.3% in 2017, lowest since 2015. The falling contribution to GDP despite steady property investment shows rising challenges for profitability faced by developers.
▪ Macau's visitor arrivals increased for the 11th consecutive month by 16.9% yoy to a record high of 3.56 million in December 2018.	▪ This was mainly led by the strong growth of same-day visitors (+28.9% yoy to a record high) owing to year-end holiday effect and infrastructure improvement. Visitors by land grew sharply by 49.8% yoy while those from Mainland China and Hong Kong increased respectively by 18.4% yoy and 19.1% yoy. This reinforces that Macau's tourism sector has well benefited from the opening of HK-Zhuhai-Macau Bridge. Lately, the market

	became less concerned about Asia's economic outlook thanks to a dovish Fed, China's supportive measures and the easing tension between the US and China. This together with the infrastructure improvement may continue to give a boost to the tourism and gaming sectors in the near term. ▪ However, we remain cautious about the medium-term outlook of the tourism and gaming sectors due to several reasons. First, given the lingering uncertainty about US-China trade war, the economy of Asia including China may continue to face headwinds. This could in turn weigh on Macau's exports of services. Second, with mega entertainment projects opened one by one, the gambling hub may no longer be able to attract overnight and high-end tourists with any further new hotel or casino. We note that the latest growth of overnight visitors (+6.5% yoy in December) was softer than that of same-day visitors. As a result, the percentage share of same-day visitors in total visitor arrivals remained high at 51.2%. Should infrastructure improvement merely help to lure same-day visitors, its support to either tourism or gaming may be limited.

RMB

Facts	OCBC Opinions
▪ RMB extended its gain against major currencies last Friday. The USDCNY retreated back to 6.75 handle again while spot RMB index broke 94 intraday.	▪ The RMB rallied last Friday despite there is no obvious trigger. The negative headline from US Commerce Secretary Ross's comments on trade talk failed to depress the currency. It seems sell on rally at 6.80 remains a favourable trading strategy for investors. ▪ Market will watch out for the upcoming US-China trade talk. Noting that US Treasury Secretary Mnuchin said last week that RMB issue will be one of the agendas for the trade talk.

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