Summary

The previous week has been remarkably eventful for China. In general, the weaker credit picture dominated headline after Dongbei Special Steel defaulted in the onshore market while we almost see the first offshore RMB bond default by State owned Guosen Securities after its HK unit technically breached the Keepwell deed. However, the stronger than expected PMI supported sentiment, signalling that easing policies are taking effects. The divergent RMB liquidity trend in both onshore and offshore market at 31 March was nothing juicy but the result of bank's adaptable to separate regulatory changes. The impact is clearly temporary. PBoC unveiled its forward book for the first time. The intervention via forward position is smaller than market expected, correcting excessive bearish tone on RMB. RMB strengthened against the dollar on broad dollar weakness while PBoC continued to set its defence line of RMB index at 98. The news about the wholly owned subsidiaries of SAFE's investment in China's equity market caught market attention. The details are yet to be known but it is likely to be a month-long topic.

Key Events	
Facts	**OCBC Opinions**
▪ The state owned steelmaker Dongbei Special Steel Group failed to repay its CNY800 million 1-year commercial paper, due on 28 March, becoming the latest victim of overcapacity. ▪ China's credit spread widened as a result of the default.	▪ Although Dongbei Special Steel was the 10th companies to have defaulted this year in China's credit space, **the incident still has the psychological impact in our view for two reasons.** *First,* it is the second default case for local administrated state owned company this year. *Second,* the lead underwriter is China's largest policy bank China Development Bank (CDB). The event is likely to raise concerns about local government's capability and willingness to intervene as well as policy bank's reputation as lead underwriters, which usually serves as credit enhancement in the past. Given the deteriorating fiscal position of some local governments amid the slowdown in growth, more defaults are expected in China's credit space.
▪ Media reported on 30 March that trustee of one dim sum bond, issued by Guosen Securities Hong Kong unit, warned bondholders of an "event of default" after the breach of Keepwell deed following auditor's report showed that Guosen HK's net worth has fallen below US$1. ▪ Should Guosen HK default, it will be the first dim sum bond default by SOE. ▪ However, market reaction has been muted with bond price is largely unchanged.	▪ It is a technical issue, which is likely to be resolved as soon as Guosen HK receives capital injection from its parent company. According to Guosen Securities, the company has received the approval from CSRC for a capital injection. ▪ **We consider this incident as company specific risk rather than systemic risk.** The technical breach of Keepwell deed is probably the result of poor communication between its onshore and offshore entities following the death of their CEO in October 2015. ▪ As long as Guosen HK will meet its CNY38 million coupon payment due on 24 Apr, the impact is likely to be contained.
▪ According to Shanghai Security News, Buttonwood Investment Platform Ltd, a wholly owned company by China's currency regulator SAFE, and its two wholly-owned subsidiaries have increased their positions in more than 10 China A-Share companies since 4Q2015. With this 27-billion-yuan investment, both Buttonwood and its subsidiaries have made the top shareholders within these companies.	▪ Though details about SAFE's investment in China's equity market yet to be known, market speculation is that PBoC was trying to help MoF and CSRC manage market sentiments or PBoC is helping China Securities and Financial Corporation, the de facto stabilization fund, to offload some positions to repay its debt to commercial banks. ▪ It may also be a simple asset reallocation. Given the impact on PBoC balance sheet is not clear. It may be too early to speculate any possible implication. Nevertheless, it will be an interesting topic to follow.

Key Economic News	
Facts	**OCBC Opinions**
▪ Both China's official PMI and Caixin PMI surprised on the upside in March. Official PMI rose back to the expansion territory at 50.2 from 49, for the first time since August 2015 while Caixin PMI also spiked to 49.7 from 48. ▪ For the breakdown, both new orders and new export orders went back to above 50, showing signs of improvement in demand. In addition, input prices rebounded sharply to 55.3 in March up from 50.2 due to recovery of commodity prices.	▪ Both official and Caixin PMI surprised on the upside partly due to seasonal effect. Although PMI is seasonally adjusted in theory, the historical pattern shows that the March reading is always higher than February reading. ▪ The rebound of PMI also benefited from two factors including improving demand and stabilized market sentiment. ▪ The rally in equity market and commodity prices in March as well as stabilization in RMB helped calmed down the fragile sentiment of manufacturers. ▪ The stronger than expected manufacturing PMI was the result of correction of excessive bearish sentiment. However, it may be too early to call for the turnaround as challenges remain this year in both domestic and international front. ▪
▪ HK total retail sales value dropped significantly by 20.6% yoy in February, the largest slump since 1999.	▪ The luxury segment continued to be the major drag on HK retail sales. Sales value of jewelry and watches contracted for the 17th straight month by 32.5% yoy in February, which was also the sixth consecutive double-digit contraction. In the near term, HK retail sector is likely to be constrained by weak inbound tourism activities, Chinese economic downturn and external uncertainties. Gloomy prospect for Hong Kong's retail sector will as a result lead to more downward pressure on HK retail shop property market. More rental concession by the landlord and higher vacancy rate in core business district could thus be expected.
▪ RMB deposits extended the declining trend, shrinking for the sixth straight month by 17.4% yoy to RMB 804 billion in February though CNH appreciated 0.67% during last month. On monthly basis, RMB deposits dipped 5.65% after the previous gain of 0.1%.	▪ The enlarged contraction in RMB deposits may be due to the Lunar New Year. However, as RMB has begun to stabilize recently, we believe the pace of RMB deposit could continue to slow in short term. On the other hand, total loan and advances increased slightly by 1.4% yoy to HK$ 7,470 billion. Loans for use outside HK dropped again by 0.8% mom, indicating that demand for Mainland related loan remained soft amid deterioration of credit quality of Mainland enterprise and lower borrowing cost in China.
▪ Macau gross gaming revenue declined at a faster pace by 16.3% yoy after Lunar New Year. ▪ Gross gaming revenue declined for the 22th straight month in March, down faster than expected by 16.3% yoy to MOP17.98 billion as the effect of festive season dissipated.	▪ While the government pins hope on the tourism sector to revive the city's growth, data showed that the new hotels opened last year failed to attract sufficient worldwide overnight visitors to offset the loss of Mainland same-day visitors who used to try their luck in the gambling centers. Given China's on-going anti-corruption campaign and the delays in the completion of some new hotel and casino projects, we believe that a solid recovery of the tourism sector remains far off, in turn casting shadow over the gaming sector, which has shifted its focus to the mass market. However, it will be difficult for the mass-market segment to cover the loss of VIP market given low profitability amid lower minimum bet. Taken all together, though we expect gross gaming revenue to decrease at a slower pace from last year, it may still fall around 5% yoy by end of this year.

RMB	
Facts	**OCBC Opinions**
▪ RMB strengthened against the USD last week with the USDCNY slipped back to 6.40-6.50 range due to global dollar weakness following Fed Chairwoman Yellen's dovish speech. However, RMB remained relatively stable against its basket currency with RMB index fell slightly to 98.01 from 98.16.	▪ PBoC continued to defend its RMB index at 98 level. The index has been around 98 level for three weeks, demonstrating how RMB index worked and played an important role in RMB pricing. We expect 98 to hold in the near term for two reasons. First, the current level indicates RMB's 3% depreciation against its basket level since the beginning of the year, which is at the edge of PBoC's commitment to keep RMB basket currency relatively stable. Second, given recent improving balance of payment and macro pictures, there is no urgency for China to lower its RMB index further.
▪ PBoC unveiled its forward book for the first time. As of Feb 2016, total outstanding of PBoC's short USDCNY forward position with tenor between 3m to 1y was at US$28.9 billion.	▪ The intervention in the forward market is smaller than market expectation. Given PBoC is moving towards more transparent reporting system, it is helpful for market to monitor their intervention strategy. ▪ It seems that PBoC continued to reduce their intervention in the forward market. As a result, China's swap points increased.

Liquidity	
Facts	**OCBC Opinions**
▪ The divergent RMB liquidity trend in onshore and offshore markets emerged on 31 March. In the offshore market, CNH overnight interbank rate fell into negative territory with the negative interest rate implied by swap travelled to as low as double digit after overnight CNH HIBOR being fixed at minus 3.725% as a result of super flush liquidity. However, in the onshore market, liquidity remained tight with 1-day repo in the Shanghai Exchange hitting a high of 12.6% intraday.	▪ The divergent liquidity trend in two RMB market was mainly driven by separate regulatory changes. ▪ In the onshore market, banks are trying to be adaptable to the newly launched macro prudential assessment framework, which resulted in reluctance to lend to non-bank financial institutions. ▪ In the offshore market, banks are still exploring the implications of RRR. But banks have the incentive to lend out to reduce their deposit balance at quarter-end, which will be used to calculate amount of reserve needed to be locked up for 3 months. Between negative interest rate for one day and freeze of liquidity for three months, market has done their calculation. ▪ Those are temporary factors. Business is expected to be as usual when new quarter starts today.

OCBC Greater China research

Tommy Xie Xied@ocbc.com

Carie Li Carierli@ocbcwh.com

Kam Liu Kamyyliu@ocbcwh.com

Co.Reg.no.:193200032W