Summary

The previous week was relatively less eventful due to short week. Positive sentiment continued to build up after China reported a stronger than expected March FX reserve data. China's FX reserve rebounded by US$10.3 billion, ending four-month consecutive decline. Indeed, the last month of the first quarter showed many positive changes. However, as mentioned by Premier Li Keqiang last Friday during his meeting with visiting German foreign minister "the basis for positive trend of China's economy is not solid yet" due to global economic downturn and fluctuated market. Apparently, market shared the similar concern as China's Premier. Despite a strong start in a short week, China's equity benchmark Shanghai index ended the week down by 0.8%, below 3000 level. China's bond yields rose due to reduced easing expectation as a result of improving economic indicators and rising inflationary pressure. The reflation talk is likely to dominate the market in the near term as March CPI due today is expected to increase further. RMB is another event risk worth monitoring closely after China allowed the RMB index to go lower below 98. Meanwhile, the HKMA responded to the negative CNH overnight interest rate seen on 31 March via setting the floor for intraday CNH repo rate at 0%. Last but not least, the debate on debt for equity program and concern about the "Ponzi scheme" in China's wealth management industry may also prevail.

Key Events and market talk	
Facts	**OCBC Opinions**
▪ Officials arrested 21 senior executives linked to a popular wealth management firm Zhongjin Capital Management in Shanghai for "illegal fundraising" despite its investors have been paid off on schedule.	▪ A wave of scandals in China's wealth management industry and internet finance has rocked China's financial market since last year. Credit default and blow-up of under regulated wealth management firms and peer to peer lending companies are likely to be the new normal for China. This will lead to reshuffle of wealth management industry. ▪ The direct impact on the real economy is unlikely to be significant. However, it is likely to have psychological impact on retail investors whose investment behaviour has been largely distorted by so called "implicit guarantee". The dream about the quick return low risk has probably come to the end. Those who swim naked started to emerge when tide goes out amid the slowdown of Chinese economy. ▪ There might be more turbulence in the short run, but in the long run, it should be good when investors are more mature. It might be good news for China's equity market, which has been crowded out by those so called quick return low risk implicit guarantee in the past few years.
▪ Local media reported that China may start its debt for equity program as much as CNY1 trillion, starting as early as this month.	▪ The idea of debt for equity swap was first flagged in early March this year as one of the possible remedies to help corporate to de-leverage while keeping banks' rising non-performing loan in check. However, this method was not a fresh idea as China has used this strategy in 1999 to contain the deteriorating credit situation when NPL rose to more than 20%. ▪ The prior experience in 1999 showed that debt for equity swap helped lower corporate's interest expense burden, buying time for corporates to go through structural reform as well as repair corporate's refinancing capability. ▪ However, the concern is that the debt for equity swap program may lead to moral hazard problem as companies may over borrow betting on the rescue from banks and governments. Meanwhile, it may transfer toxic assets from zombie corporates to banks. ▪ Although there is still lack of details about this program, the speculation is that those bad debts may be converted to

	preference share instead of common share. This will alleviate pressures faced by banks as banks can still receive its dividend from preference share to cover the loss of interests.
▪ Hong Kong Urban Renewal Authority (URA) has completed its first subsidized housing project in advance. It invited totally 264 elected applicants to choose their units, starting from last Tuesday to last Friday. However, as at the end of last Friday, no more than 20 applicants signed the transaction agreement for each day. A total of 61 buyers accounted only 23% out of the total invitees.	▪ The negative sentiment against the subsidized housing project could be attributable to two reasons. *First,* given the uncertainty over Hong Kong's outlook, prospective home buyers believe that the housing market is yet to bottom out, albeit the declining housing price. As such, they tend to stay aside from the market. *Second,* as subsidized housing project, the price is lower than the market price. Therefore, when investors are bullish on the housing market, they will rush to buy subsidized housing units, in order to sell it at a higher price later on by paying the land premium. However, as for this project, the URA does not cut the price, but rather adjust the discount rate to the market price from the previous 20% to 14%. Now, the housing market is in its correction period. Even though investors buy the unit at a 14% discount, they may still suffer loss if they want to sell some time later.

Key Economic News

Facts	OCBC Opinions
▪ China's FX reserve rebounded in March by US$10.3 billion to US$3.21 trillion, ending four-month decline trend. ▪ Meanwhile, PBoC also released the FX reserve denominated in SDR for the first time. In SDR term, China's FX reserve fell to SDR2.28 trillion in March from SDR2.32 trillion in Feb due to broad dollar weakness. Noting that SDR appreciated against the dollar in March.	▪ The latest FX reserve data confirmed that sentiment has stabilized thanks to government intervention and dollar weakness after the Fed paused its tightening cycle. However, the small increase of FX reserve in March did not signal the turnaround of capital outflows. We still expect to see net capital outflow albeit at a smaller pace in March. The rebound of FX reserve was mainly the result of positive valuation effect, which benefit from broad dollar weakness and stronger risky assets in March. ▪ The temporary diminishing Fed rate hike expectation and improving economic data in China are likely to further support market sentiment, which is expected to stabilize capital flows. After market is adaptable to the concept of RMB index, we may have passed the worst and the probability of disorderly RMB depreciation has diminished significantly. ▪ However, it is still too early to call for the reversal of capital outflows as the outlook of capital flows will also depend on the dollar trajectory. Should dollar regain its strength, capital outflow may return. ▪ The first release of China's FX reserve in SDR was in line with PBoC's advocation for reducing global reliance on dollar. It has limited impact for now; however, China may continue to promote SDR via issuing bond priced in SDR.

RMB

Facts	OCBC Opinions
▪ Divergent trend emerged last week with RMB strengthened against dollar in the onshore market while weakening against the dollar in the offshore market. The weakness in the offshore market was mainly the result of RMB's on-going depreciation against the basket currency in our view. RMB index broke down 98 last week,	▪ China allowed RMB index to go lower again to below 98 after keeping the index marginally above 98 for two weeks. Despite the break of key 98 levels, our view that RMB index will continue to play a dominant role in deciding where USDCNY traded has not changed. Nevertheless, given the fact that China continue to guide the RMB index lower in the past week, that does raise questions about whether the authority

ending the week at 97.64, marking 3.3% depreciation against the basket currency year to date.	prefers to see a weaker currency. ▪ The bottom for RMB index is not clear now after the index losing the defence of important 98. Should dollar regain its strength in the global market, the risk for USDCNY to overshoot higher cannot be ruled out.

Liquidity	
Facts	**OCBC Opinions**
▪ HKMA firstly set intraday and overnight minimum repo rates under Yuan liquidity facility respectively at 0% and 0.5%	▪ The new rule was triggered by the unexpected negative CNH overnight HIBOR on 31 March. Given the intraday CNH repo rate (annualized) is calculated based on the average of the previous three trading day's overnight CNH HIBOR. The new regulation indicates that the HKMA does not want to see negative overnight CNH HIBOR for several consecutive days. We believe that the possibility of overnight CNH HIBOR slipping to the negative territory again is relatively small; with the HK banks getting more adapted to the new RRR imposed every quarter end.

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