

### Summary

RMB's gain from disappointed US non-farm data proved to be short-lived. The forecasted two-way movement of RMB failed to materialize. The fall of RMB against both dollar and basket currency raised some concerns in the market though it is the result of recent fixing mechanism, which drove the USDCNH to break above 6.6 last Friday. Today's stronger than expected RMB fixing shows that minor adjustment may have been made to smooth out the rising RMB volatility amid choppy dollar movement in the global market. It will be seen whether China will set up the line of defence at 6.6 level. The notable upward revision of consumer inflation forecast in the latest PBoC research paper caught market attention as the higher than expected CPI may further reduce easing expectation. For this week, in addition to China's May economic data, whether Bohai Steel will be able to pay coupon to its offshore dim sum bond investors will be watched.

Key Events and market talk	
Facts	OCBC Opinions
<ul style="list-style-type: none"> <li>China announced to allocate CNY250 billion RQFII quota to the US after concluding its two-days Strategic and Economic dialogue.</li> <li>Meanwhile, the PBoC and Fed have also signed the MoU to set up the RMB settlement in the US.</li> </ul>	<ul style="list-style-type: none"> <li>The CNY250 billion RQFII quota is the second largest after Hong Kong. Together with the setup of RMB clearing and settlement in the US, it will help promote the use of RMB in bilateral trade and investment between US and China.</li> <li>The opening of onshore stock and bond market to US investors may increase the chance of A-share to be included in the MSCI index.</li> </ul>
<ul style="list-style-type: none"> <li>In its latest working paper, PBoC research department revised China's 2016 CPI forecast up by 0.7% to 2.4% from previously projected 1.7% while maintaining its GDP forecast unchanged at 6.8%.</li> </ul>	<ul style="list-style-type: none"> <li>According to the research paper, the upward revision of CPI forecast was mainly attributable to three reasons including 1) the higher than usual food prices due to weather, 2) the transmission effect from the rebound of PPI on the back of rise of commodity prices in recent months, and 3) the transmission from higher property prices.</li> <li>Though the working paper does not represent PBoC's official view, the notable upward revision of consumer inflation forecast still caught market attention as the higher than expected CPI may further reduce easing expectation, which has already been low following the comments from authoritative persons in May.</li> </ul>
<ul style="list-style-type: none"> <li>PBoC deputy Governor Zhang Tao said China should allow financial institutions to fail in an orderly way.</li> </ul>	<ul style="list-style-type: none"> <li>This is in line with China's SOE reform strategy to eventually close down those non-performing zombie companies or financial institutions. However, details remained to be seen.</li> </ul>
<ul style="list-style-type: none"> <li>The first dim sum bond default may hit the market should Bohai Steel fail to pay the coupon on 16 June.</li> </ul>	<ul style="list-style-type: none"> <li>The price of 1.5 billion yuan Dim Sum Bond due in Oct 2017 issued by the Bohai Steel tumbled sharply as the investors priced in the increased credit risks. Recently, Bohai Steel showed increasing probability to default on its Dim Sum Bond. This may negatively affect the offshore RMB bond market with investors turning more cautious on Chinese names. Also, the increased number of credit events in the onshore market this year may have dampened offshore investors' demand for the offshore bonds issued by Chinese companies which are struggling with overcapacity. Nevertheless, Chinese companies tend to raise fund in the onshore market thanks to lower borrowing cost, making the foreign companies took up 80% of Dim Sum Bond issuances so far this year. In this case, given the increasing number of RMB FX risk hedging tools and the relatively high yields, we believe that the offshore RMB bonds' appeal to investors is still there.</li> </ul>

Key Economic News	
Facts	OCBC Opinions
<ul style="list-style-type: none"> <li>China's FX reserve fell by US\$27.96 billion in May to US\$3.191 trillion, below US\$3.2 trillion for the first time since December 2011.</li> </ul>	<ul style="list-style-type: none"> <li>The currency regulator SAFE argued in its weibo account that the decline of FX reserve in May was mainly due to the valuation effect. We think valuation effect play a big part given the strong dollar and generally weaker equity market in May. However, we doubt that the trend of capital outflows has been reversed. The prominent mismatch between China's import from Hong Kong and Hong Kong's export to China in recent month pointed towards the pressure of capital outflows.</li> <li>Having said that, we believe the outflow is generally in an orderly fashion thanks to a more transparent fixing mechanism as well as powerful window guidance. The recent opening of onshore interbank bond market in the medium term are likely to provide a buffer to capital outflows.</li> </ul>
<ul style="list-style-type: none"> <li>China's CPI grew by 2% in May while PPI contracted by less than expected 2.8%.</li> </ul>	<ul style="list-style-type: none"> <li>CPI fell by more than expected 0.5% month-on-month due to weaker than expected vegetable prices, which fell by 21.5% mom, overshadowing the small gain in pork prices. Given the vegetable price is likely to fall further in the coming months, we expect overall food price to contract further. As such, we expect CPI to break below 2% in June.</li> <li>PPI increased by 0.5% mom in May, up for the third straight month, beating market expectation on the back of recent rise of commodity prices. The less than expected contraction of PPI also shows the easing pressure from excessive capacity problem in our view.</li> </ul>
<ul style="list-style-type: none"> <li>China's export fell by 4.1% in May while the contraction of import narrowed to 0.4% from 10.9% in April. Trade surplus widened to US\$50 billion.</li> </ul>	<ul style="list-style-type: none"> <li>Demand from emerging market improved while demand from advanced economy remained weak. For example, export to US fell by 12% and exports to Japan fell by 5.6%.</li> <li>Imports of general trade grew by 3.9% in May partly benefiting from the strong property market.</li> </ul>
<ul style="list-style-type: none"> <li>Macau's housing transaction volume surged at the fastest rate since Feb 2013, up by 61.5% on yearly basis to 1045 units in April.</li> </ul>	<ul style="list-style-type: none"> <li>Thanks to the recent signs of recovery in the tourism and gaming sectors as well as the consistently low borrowing costs, potential home buyers of low-end flats entered the market. More end-users buying low-end flats also pushed housing prices up by 0.3% YTD in April. Nevertheless, the increased transaction volume did no translated into higher demand for new residential mortgage loans (RML), which dropped in 7 out of the past 8 months and was down by 35% yoy in April. Fears of steep increase in borrowing cost amid Fed's tightening may be the main reason behind homebuyers' persistent cautiousness of mortgage loans. Moving forward, though increasing labor demand from new hotels and casinos will attract more non-local residents to work in Macau, this group of labours tends to resides outside the city, lending little momentum to Macau's housing market. Slower wage growth and an expected contraction of Macau's growth this year may also dent housing market demand. In the short term, before borrowing cost soar, some prospective home buyers are still likely to purchase small housing units. However, as a great number of junkets have left Macau amid deteriorating VIP market, housing transaction volume is not expected to return to the peak levels reached during 2012-2013 (monthly average of 1,206 units). In a medium term, increasing supply in coming 1-2 years and broad-based sour demand may push housing</li> </ul>

	prices down by 10% yoy by end of this year.
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<b>RMB</b>	
<b>Facts</b>	<b>OCBC Opinions</b>
<ul style="list-style-type: none"><li>▪ RMB weakened against both dollar and basket currency last week in a holiday short week. RMB index fell to 96.01 on Wednesday ahead of Rice Dumpling Festival holiday, lowest in record since the launch of the index.</li><li>▪ The USDCNH managed to break above 6.60 on Friday in absence of onshore market.</li></ul>	<ul style="list-style-type: none"><li>▪ The fall of RMB against both dollar and basket currency raised some concerns in the market though it is the result of recent fixing mechanism, which drove the USDCNH to break above 6.6 last Friday.</li><li>▪ Nevertheless, based on today's fixing, it seems that minor adjustment has been made to smooth out the rising RMB volatility amid choppy dollar movement in the global market. It will be seen whether China will set up the line of defence at 6.6 level.</li></ul>

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