Summary

China's State Council released two detailed guidelines on lowering the corporate leverage and debt-to-equity swap program. Unlike the debt-to-equity swap in 1990s, the new program will be market oriented with no final state guarantee. The new debt-to-equity swap is not designed for banks to offload their bad loans but to help corporate to lower their leverage ratio and funding costs. You may refer to our thoughts below. Nevertheless, market remains sceptical about this program as the turnaround of companies participating in the debt-to-equity program could be longer compared with that in late 1990s when most companies walk out of trough faster thanks to property boom in early 2000s.

PBoC deputy Governor Fan Yifei said in response to the latest guideline on debt-to-equity swap that PBoC will maintain its monetary policy prudent with timely fine-tuning to support government's plan to lower corporate leverage. The reiteration of prudent monetary policy is read as less easing bias in the current context. The stronger than expected CPI and PPI again curbed expectation on further easing.

China's announcement to resolve hukou issue for 100 million migrant workers to boost urbanization rate of household registered population is the area to be watched closely in the medium term though the short term impact is likely to be muted. You may refer to the paragraph below for our quick thoughts on this issue.

RMB has weakened at a gradual pace last week after the USDCNY fixing was set higher above 6.70 last Monday. Clearly, PBoC shows higher tolerance for higher two-way volatility after RMB's inclusion into SDR basket. RMB is likely to be event-driven going forwards. PBoC is likely to take advantage of big event or big dollar rally to allow RMB weaken against the dollar. The USDCNY fixing is likely to test 6.74 this morning after DXY recouped most of losses last Friday.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China's State Council released two detailed guidelines on lowering the corporate leverage and debt-to-equity swap program.	▪ Debt to equity swap is not new to China. In late 1990s, China created special asset-management companies to strip the troubled debt from big four Chinese banks, which part of debt was converted to equity under the direction of government. ▪ **Unlike the debt-to-equity swap in 1990s, the new program has two distinct features.** First, it will be market oriented with no final state guarantee. The transfer of debt and the price of equity will be determined by market players. Second, not only troubled debt but "normal" loan can also be swapped to equity. As mentioned by CBRC Vice Chairman, **the new debt-to-equity swap is not designed for banks to offload their bad loans but to help corporate to lower their leverage ratio and funding costs.** ▪ There are three important highlights from the latest guidelines including avenues to lower corporate leverage, bank's role and qualification of the companies. ▪ ***First,*** there are four avenues encouraged by government to lower corporate leverage including merger and acquisition, bankruptcy, debt-to-swap and debt securitization. ▪ ***Second,*** banks are barred from converting debt to equity directly. Instead, banks will transfer debt to qualified third-party agent including its own subsidiary to conduct debt-to-equity swap. ▪ ***Third and most importantly,*** government released both positive list and negative list to set the boundary for companies to be qualified for debt-to-equity swap. As a general guideline, the program will only help those companies with good long term prospect but facing temporary difficulties. Zombie companies and companies which are losing money in overcapacity sectors will not be qualified for the program. As highlighted by government, the program is "by no means a free lunch"

	▪ **Challenges:** market remains sceptical about this program for two main reasons. First, a good company is unlikely to give up their shares to swap their debt. As such, investors may end up with shares they don't want. Second, it may take longer for investors to recover its investment due to change of macro condition. Unlike late 1990s, most company participating in debt-to-equity program walked out of the trough quickly thanks to property boom in early 2000s. However, given the concern about the property bubble, the turnaround of the companies participating in the current debt-to-equity swap could take longer.
▪ PBoC deputy Governor Fan Yifei said in response to the latest guideline on debt-to-equity swap that PBoC will maintain its monetary policy prudent with timely fine-tuning to support government's plan to lower corporate leverage.	▪ The reiteration of prudent monetary policy is read as less easing bias in the current context. Given China has stepped up fighting against the property bubble, China is unlikely to ease monetary policy more aggressively due to concerns that it may worsen the high leverage problem. As such, we reiterated our view on no interest rate and reserve requirement ratio cut this year.
▪ China's State Council announced to resolve hukou issue for 100 million migrant workers to boost urbanization rate of household registered population. The rate is expected to rise by an average of 1% (or 13 millions) each year to 45% by 2020.	▪ Urban area with fast development, especially tier-1 and tier-2 cities, have lured a large amount of rural-migrant workers. However, it is difficult for the rural-migrant workers to get a hukou in the urban area. As a result, they are subordinate to the household registered population in terms of education, home-purchase, healthcare system and so on. During the latest round of curbs on home purchases in the tier-1 and tier-2 cities, the non-local residents are hardly hit. Moreover, rural-migrant workers are reluctant to get hukou as they do not want to forfeit the land right in the rural area. As a result, some migrant workers even moved back to their hometowns and slowed the pace of urbanization. ▪ If it is possible for the migrant workers to get hukou in tier-3 or tier-4 cities, they may bring housing demand to these cities and lend momentum to the sagging housing markets. In the meantime, with the urbanization of lower-tier cities, the education, housing, household goods & furnishings, recreation and culture, transportation and communication as well as consumer staples sectors in these cities may be underpinned. This is in line with the aim of economic transition from manufacturing- and investment-led growth to services and consumption-driven development. As a result, the pace of de-stock in the lower-tier cities' housing market may be able to accelerate. Besides, the local governments will be prompted to improve infrastructure development, which will support the economic growth. Also, the saturation of the upper-cities will also be eased if the hukou system is improved. ▪ In the longer term, through urbanization, increasing investment on "Intelligent city" will underpin the high technology sector. And the advocate of green economy will benefit the environment protection industry.
▪ The Chief Executive of HKEX stated that Shenzhen-Hong Kong Stock Connect will be launched on a Monday after mid-November.	▪ The new stock connect came out at the right time when the renewed concern about RMB depreciation emerged and announcement of property tightening measures in various cities. The new connect may be the new channel for onshore investors to hedge against the RMB depreciation risk.
▪ The Hong Kong Mortgage Corporation Limited owned by Hong Kong government announced to expand the coverage of reverse mortgage plan to	▪ Specifically, the collateral for reverse mortgage could be not only private homes but also houses under Home Ownership Scheme, Sandwich Class Housing Scheme and Public Rental

public housing.	Housing Scheme. As such, the number of eligible housing units as collateral is expected to increase by 400K. But the applicants with public housing units are required to be aged 60 or above, an increase from the age requirement of 55 or above for applicants with private housing units. Should the market value of the property is HK$1 million, for applicant who is aged 60 and chooses to receive annuity for 10 years, he or she will be able to get HK$3700 per month. We expect the new rules will help ease the poverty of the elder residents (poverty rate of the elderly aged 65 or above was nearly 45% in Hong Kong).
▪ Overnight CNH HIBOR rose for the fourth consecutive trading day to 3.8422% on 13 Oct.	▪ CNH liquidity has been one of the important tools to manage market expectation on RMB. Nevertheless, we doubt CNH interest rate will spike to the level as seen in January and September after RMB's inclusion to SDR basket. HK banking is likely to declare another around of CNH time deposit rate hike battle to ease the impact of tighter liquidity. Some bank has already lifted the CNH 3-month time deposit rate to as high as 4.1% per annum.

Key Economic News	
Facts	**OCBC Opinions**
▪ Exports fell more than expectation by 10% in September in dollar term despite improving new export orders reported by PMI. ▪ Imports fell by 1.9% in September in dollar term, in line with market expectation.	▪ The decline of exports was broad based with demand from both G3 and emerging market fell notably. Exports to EU and US fell by 9.8% and 8.1% respectively while exports to ASEAN fell by 10.8%. ▪ Demand for major commodity increased with imports of crude oil and iron ore by volume rose by 18.3% and 8% respectively. ▪ As a result of weaker than expected exports number, China's trade surplus narrowed significantly to US$41.99 billion. Should trade surplus continue to weaken, this may shaken market's expectation on RMB again.
▪ Both CPI and PPI surprised the market on the upside in September. CPI accelerated to 1.9% from 1.3% in August. ▪ PPI returned to positive growth for the first time in 55 months.	▪ CPI grew by 0.7% mom. The rebound of consumer price was mainly driven by rapid increase of food prices ahead of golden week holiday. Vegetable prices and meat prices, for example, rose by 7.5% yoy and 4.4% yoy respectively in September. In addition, non-food prices also rose more than expected led by housing, cloths and education. The CPI is expected to rise further to above 2% in Q4 due to base effect. This is likely to curb market expectation on easing monetary policy. ▪ PPI rose by 0.5% mom as a result of higher coal and steel prices. The PPI is expected to accelerate further in October due to rise of oil prices.

RMB	
Facts	**OCBC Opinions**
▪ RMB has weakened at a gradual pace last week after the USDCNY fixing was set higher above 6.70 last Monday. ▪ However, RMB index rebounded to 94.64, tracking stronger dollar index.	▪ Clearly, PBoC shows higher tolerance for higher two-way volatility after RMB's inclusion into SDR basket. RMB is likely to be event-driven going forwards. PBoC is likely to take advantage of big event or big dollar rally to allow RMB weaken against the dollar. ▪ Nevertheless, one thing is clear that China will not allow big depreciation of RMB. And current pace of depreciation will be gradual, depending on the dollar movement in the global

	market. ▪ The USDCNY fixing is likely to test 6.74 this morning after DXY recouped most of losses last Friday.

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