

Summary

China's equity market ended flat in a relatively event light week. However, RMB headed for another weekly loss amid dollar strength on renewed Fed tightening expectation in summer. Nevertheless, the 0.39% gain in RMB Index helped contain the volatility in the currency market. As such, the renewed Yuan's weakness has not induced fresh round of disorderly sale of RMB. China's capital outflows continued to moderate in April supported by the latest foreign exchange settlement and sale data. Nevertheless, the trend of capital outflows has not been reversed yet despite improving willingness from corporates to sell foreign currency. Should dollar strength prevail, it may affect the market sentiment, which may trigger another round of corporate dollar purchase. The first liquidity injection via MLF and reverse repo in four week failed to support the bond market with bond yields moved slightly higher.

China further opened its onshore interbank currency market to offshore commercial players. Since late last year, China's capital account liberalization has been lopsided, meaning the reform is more focusing on attracting capital inflows rather than allowing more capital outflows. This should be positive for capital inflows in the medium term. For this week, market interest will shift to the issuance of ABS by Bank of China backed by non-performing loans.

Key Events and market talk	
Facts	OCBC Opinions
<ul style="list-style-type: none"> ▪ China gave the green light to first batch of offshore participating banks including ICBC Asia, China Merchant bank Hong Kong branch, CTBC Bank, Taipei Fubon Bank, Standard Chartered bank Hong Kong branch and Citibank Hong Kong branch to enter China's onshore interbank FX market. 	<ul style="list-style-type: none"> ▪ This is another step for China to further open its capital account to foreign participants. China first allowed qualified central banks to access to interbank FX market last September. IMF and ADB joined the market in April 2016. ▪ The open of the market to offshore commercial players is likely to further deepen the development of onshore spot, forward, swap and option market. ▪ Since late last year, China's capital account liberalization has been lopsided, meaning the reform is more focusing on attracting capital inflows rather than allowing more capital outflows. The open of onshore interbank FX market is in line with China's current strategy to attract more capital inflows. ▪ The increasing participation of offshore commercial players is also likely to enhance price discovery and narrow the gap between onshore and offshore RMB market. ▪ In the longer run, the open of onshore FX market will provide more effective hedging tools to those offshore players, who are able to access to onshore capital markets. This will make RMB assets more appealing to offshore players. As a result, it will be supportive to RMB internationalization.
<ul style="list-style-type: none"> ▪ Bank of China plans to sell security backed by non-performing loan this week. 	<ul style="list-style-type: none"> ▪ China's asset backed securitization market kicked off in 2005, however, the exercise was shut down in 2008 after global financial crisis. China re-launched the securitization market from 2012 and the market developed at a rapid pace, which took over South Korea as the largest securitization market in 2014. However, the issuance backed by non-performing loans was not allowed until February 2016. ▪ China granted a total CNY50 billion quota to six banks to issue ABS backed by non-performing loans, adding alternative way for Chinese banks to manage their rising NPLs.
<ul style="list-style-type: none"> ▪ Property developer Greenland denied the report from the Wall Street Journal that Chinese government has told the company to restrict its overseas investment. 	<ul style="list-style-type: none"> ▪ The spike in overseas direct investment as well as the surge in China's imports from Hong Kong showed that China may still need to be vigilant to capital flows despite stabilization in RMB exchange rate.

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| <ul style="list-style-type: none"> Guangdong Province announced to lower the income tax for small and micro companies to 15% from 20%. | <ul style="list-style-type: none"> The move is in line with China's supply side structural reform to lower the cost for small companies. This will also help encourage more private investment in the medium term. |
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Key Economic News

Facts	OCBC Opinions
<ul style="list-style-type: none"> Foreign Exchange settlement and purchase by bank: China's capital outflow continued to moderate as evidenced by April foreign exchange settlement and purchase by bank. The net foreign exchange purchase by bank fell to US\$23.7 billion from US\$36 billion in March. 	<ul style="list-style-type: none"> Willingness of sale of foreign exchange by clients improved in April due to reduced concern about Yuan's devaluation with the ratio of foreign exchange settlement by bank on behalf of clients to cross border foreign currency receipts increased to 49% in April from 46.6% in March, signalling increasing willingness for corporates to sell foreign currency. However, despite improvement, the data showed that trend of capital outflows have not been reversed yet albeit at a slower pace. Capital flows may be still sensitive to expectation on RMB. Should dollar gain last more than expected, capital outflows may worsen though we think the disorderly sale of RMB is quite unlikely.
<ul style="list-style-type: none"> Hong Kong: The seasonally adjusted unemployment rate remained high at 3.4% in April. 	<ul style="list-style-type: none"> Increases were more visible in the "construction" and "professional & business" sector. Unemployment rate in the retail sector rose to 5.3% from 5.1% in April, the highest since May 2013, as business performance in retail sales was lacklustre amid shrinking tourist spending. We expect that the anti-corruption campaign and unstable environment in HK will continue to dampen HK's tourism sector as well as retail sales sector. In addition, unemployment in the trade and wholesale sector remained high at 2.9% amid muted external demand while unemployment in construction sector climbed further to 11th-month high of 5.4%. The increase was attributed to the recent consolidation in the property market, the fall-off in construction activity as well as seasonality factor. Looking forward, corporate hiring sentiment could remain overshadowed given a sluggish domestic economy and dimmer business performance.
<ul style="list-style-type: none"> Macau housing transaction volume's rebounded by 9.1% yoy while average transaction price slid for the fourth straight quarter by 18.5% yoy in 1Q. 	<ul style="list-style-type: none"> Recent signs of bottoming out in game sector and rebound in tourism activities have underpinned housing market sentiment. Besides, average transaction price edged down 34.6% in 1Q from the peak in 2Q 2014. Lower housing prices have attracted some end-users. Adding demand from the stably increased non-local labors, housing transaction volume sustained its rebound despite slimmer demand for the high-end flats. Looking ahead, we believe that housing transaction volume will stabilize at around 500 units in the 1H should more data help to confirm the recovery of both tourism and gaming sectors. Despite this, tepid demand amid expected slower wage growths coupled with increasing supply indicates that the housing price is yet to bottom out. We expect Macau's residential transaction price to edge down by around 10% yoy by end of this year.

RMB

Facts	OCBC Opinions
<ul style="list-style-type: none"> RMB headed for another weekly loss amid dollar 	<ul style="list-style-type: none"> The fact that RMB index has been guided higher for the past

<p>strength on renewed Fed tightening expectation in summer. However, RMB has been well behaved in onshore market after RMB index gained 0.39% last week.</p>	<p>two week showed that China’s strategy to contain volatility via stronger fixing. It seems to have been working well for the past two months given the renewed Yuan’s weakness did not induce fresh round of disorderly sale.</p> <ul style="list-style-type: none"> ▪ Nevertheless, the daily USDCNY trading volume has picked gradually in the onshore market. Should dollar strength prevail too long, it may affect the market sentiment, which may trigger another round of corporate dollar purchase.
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Liquidity	
Facts	OCBC Opinions
<ul style="list-style-type: none"> ▪ PBoC injected CNY290 billion via MLF on 16 May with interest rates remained unchanged. ▪ Meanwhile, China net injected CNY50 billion via reverse repo last week, first net injection in four weeks. 	<ul style="list-style-type: none"> ▪ The CNY290 billion injection has exceeded CNY150 billion MLF maturing in the month of May. This added confusion to market on whether there is any policy shift following the hawkish comments by authoritative person about the credit expansion and leverage.

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