Summary

The data-light past week turned out to be another exciting week led by the spike of commodity prices in China's futures market and further correction of bond market. China's ferrous metal futures have trended up since March due to stabilized global sentiment and signs of improving economic data in China. The rally has accelerated since April as the result of increasing belief that China will continue to rely on infrastructure and property sectors to support the growth as well as ample liquidity. The almost 20% rally in the first four days of last week triggered government reaction to increase the transaction fees to curb speculation. The fact that trading volume for steel rebar contracts was at 223 million tons of rebar last Thursday, more than China's full year production of steel rebar raised concerns about the repeat of boom bust scenario seen last year in China's equity market.

There is more drama in China's bond market, the early bond redemption request from two local government funding vehicles and the split up news of troubled Bohai Steel Group may further raise the concern about the moral hazard issue in China's bond market and dampened the relationship between issuers and investors. China's bond market has been under pressure in the past few weeks due to four reasons including 1) liquidity concern due to reduced easing expectation, 2) rising credit risk due to default and moral hazard, 3) potential rising cost after change of tax structure to value added tax system from May and 4) financial institutions' deleverage efforts in bond holdings. Having said that, we think the current stress is not enough to trigger any more easing measures from PBoC. The massive liquidity injection from PBoC via reverse repo and MLF shows PBoC's reluctance to cut RRR. Hopefully, we will have a quiet week ahead of Labor Day long weekend.

Key Events and market talk	
Facts	**OCBC Opinions**
▪ Two local government funding vehicles including one from Hebei province and one from Hainan Province announced their plan last week for early redemption of their existing bonds issued in 2014 due to falling interest rates. This sparked concern that investors in the secondary market may suffer from losses should issuers redeem the bonds only at face value. ▪ According to local news, Tianjin government has approved in principal to split up the troubled Bohai steel group to move its four core manufacturers to under supervision of Tianjin SASAC. ▪ China's four top financial regulators including PBoC, CBRC, CSRC and CIRC jointly released the new guidance to ask borrowers in steel and coal industries to release information in a timely manner to prevent from the rising phenomenal of departing from their debt obligation on purpose.	▪ Those are three separate news, the reason we put them together is because that three news share the same underlying concern about the rising moral hazard in China's bond market. The latest early bond redemption request from local government funding vehicles due to falling interest rate as well as the shift of assets between "good company" and "bad company" when issuer defaults have dampened the relationship between issuers and investors. This may further weigh down sentiment in China's credit space together with rising default risk.
▪ Market talk is that China is going to replace the current business tax system with value added tax system in financial market with effective from 1st May. This raises concern about the potential rising cost for financial transaction.	▪ Talking to the tax experts on the ground, the consensus view about the upcoming implementation of value added tax is that the new tax regime will increase cost for financial sectors though it is designed to lower the tax on average.

▪ The recent rally in ferrous metal in China's future market extended last week, unaffected by weak equity market. The fever spread to other commodity futures such as cotton and egg. This triggered government action to increase transaction fees last Thursday. ▪ The most popular steel rebar futures rose by close to 20% last week ahead of the announcement of new transaction fees. The steel rebar futures have gone up by more than 50% year to date.	▪ The recent broad based rally in commodity futures was the result of two factors including increasing belief that China will continue to rely on infrastructure and property sectors to support the growth as well as ample liquidity. ▪ However, the fact that trading volume for steel rebar last Thursday hit more than CNY600 billion, more than the combined daily trading volume of Shanghai and Shenzhen stock exchange and contracts on more than 223 million tons of rebar changed hands more than China's full year production of steel rebar showed that speculative forces may have played an important role in China's latest rally. The risk for the correction of commodity prices cannot be ruled out.

Key Economic News

Facts	OCBC Opinions
▪ **Foreign currency sale and purchase data:** China's central bank net sold US$33.6 billion foreign exchange on behalf of clients in March, down from US$35 billion in February and US$69.4 billion in January. ▪ The deficit of foreign exchange receipts and payments narrowed to US$26.1 billion from US$30.5 billion in Feb and US$55.8 billion in January. ▪ Companies and individuals' motive to purchase foreign exchange weakened with foreign exchange purchase by companies and individuals as percentage of foreign exchange payments dropped to 74% in Feb and March from 90% in Jan. ▪ However, willingness to sell foreign exchange remains low with foreign exchange sold by companies and individuals as percentage of foreign exchange income in March was at 59%.	▪ China's capital outflows continued to moderate in March. However, unlike the FX reserve data, which showed a small rebound in March, the net sale of foreign exchange by banks suggests that the trend of capital outflow has not been reversed yet. This also confirms our view that the recovery of March FX reserve data is mainly due to valuation effect. ▪ On the positive note, the companies and individuals no longer rushed to buy foreign currency as evidenced by the decline of foreign exchange purchase as percentage of foreign exchange payments. However, the still weak willingness for companies and individuals to settle their foreign currency receipts also shows the caution of sentiment. As such, the PBoC is likely to maintain its vigilance over the potential capital outflow risk should global sentiment change again.
▪ **Hong Kong:** unemployment rate rose to highest level since late 2013 in March amid dimmer business performance. After remaining stable for eighth straight month, the seasonally adjusted unemployment rate increased from 3.3% to 3.4% in March.	▪ Increases were more visible in the construction sector and retail sector. Unemployment rate in the retail sector surged to 5.1% from 4.6% in March, highest since May 2013, as business performance in retail sales was lacklustre amid shrinking tourist spending. Unemployment rate in trade and wholesale sector rose further to 2.9%, highest in recent 9 months while unemployment rate in construction sector surged to 10-month high of 4.9%. Looking forward, corporate hiring sentiment could remain clouded given the uncertain economic prospects. We expect the employment of retail sector would continue to face headwind. As a result, this may weigh on local consumption and reinforce an even weaker labor market.

▪ **Macau:** revenue from VIP rooms dropped for the 8th straight quarter by 19.3% yoy while that from mass-market segment slid at a much slower pace, down by 5.2% yoy.	▪ Due to the ongoing anti-corruption campaign in Mainland China, previous high rollers stayed away from the Macau's VIP tables. As such, revenue from the VIP tables continued to drop and prompted the casino operators to shift their focus to the mass-market segment. Specifically, the share of mass-market segment increased to 40.8%, as compared to an average of 32.8% during 2012-2015. Thanks to the new hotel openings last year, overnight visitors have been increasing for the eighth straight month, up sharply by 14.1% yoy in March. The opening of new casinos also led to an increase of 273 gambling tables from 2Q 2015. However, the minimum bet amount for each mass-market table is relatively low and the growth of gaming tables is limited due to government's restrictions. More notably, though China's middle-class is expanding, China's increasing outbound visitors prefer Japan and South Korea instead of Macau as their travel destination, clouding the prospects of Macau's tourism sector. With mass-market's share still falling below 50%, adding limited growth of gaming tables and the slow recovery of tourism activities, Macau's gaming sector may remain subdued. And the market sentiment and the city's housing market are expected to take a hit as well.

RMB	
Facts	**OCBC Opinions**
▪ RMB weakened against both basket currency and dollar last week.	▪ The USDCNY spot ended the week at high of 6.4995, close to important 6.5000 handle due to rebound of broad dollar and depreciation bias image created by PBoC as the result of quiet depreciation of RMB against its basket value. Our view for the upside risk for USDCNY remains unchanged.

Liquidity	
Facts	**OCBC Opinions**
▪ PBoC pumped CNY680 billion into the banking system last week in its open market operation via reverse repo. This was the second largest single week injection. Meanwhile, PBoC also injected another CNY162.5 billion liquidity via 3-month and 6-month medium term lending facility (MLF)	▪ The massive liquidity injection via both reverse repo and MLF failed to calm down the concern about tighter liquidity ahead of tax payments and maturing of previous MLF and reverse repo. Interbank fixing repo rate increased to 2.55% last Friday from Monday's 2.35%. ▪ The combined use of open market operation and reverse repo signals PBoC's reluctant to cut RRR in the near term.

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