Summary

China's equity market could have shined in the first week of May, withstanding the "Sell in May" syndrome, if there were no sold off in the last half an hour. Shanghai index ended the week down 0.85% after losing 2.82% on Friday, but still outperforming most of its counterparties in the region. The risk sentiment was weighed down by renewed concern about RMB, reduced expectation on further easing as well as liquidity concern arising from the new regulation to contain off-balance sheet risk. However, China's bond market stabilized despite credit default event continues.

The rebound of US dollar in the global market put China's RMB policy under question again. The fact that China continued to guide RMB weaker against its basket currency despite the rebound of dollar last week flagged the warning signal that China may prefer a weaker basket currency. This raised the concern that Yuan may have to depreciate faster against the dollar should the dollar regain strength in the global market, which also drove the Asian currencies weaker last week. **Nevertheless, PBoC reiterated the role of RMB basket currency in the setting of daily fixing saying that the daily fixing will depend on two parameters including previous closing price at 4:30pm and the move of RMB basket currency.** Expectation on further RRR cut diminished after PBoC announced to make PSL a more regular tool. Meanwhile, PBoC continued to net withdraw liquidity via open market operation last week, signalling caution in liquidity management. The better than expected April FX reserve data should offset weaker than expected trade data. Both data, released over the weekend, are unlikely to change market sentiment significantly. Market will watch for more China data this week.

Key Events and market talk	
Facts	**OCBC Opinions**
▪ PBoC announced to make pledged supplementary lending (PSL) a more regular tool to three policy banks including China Development Bank, Agricultural Development Bank of China and Export-Import Bank of China. From May, three policy banks will receive credit on the monthly basis to support targeted sectors such as redevelopment of run-down urban areas and important water projects.	▪ We see two implications from PBoC's increasing use of PSL. First, it clearly shows China's commitment to support growth as most of credit will be channelled to targeted infrastructure projects. The supportive government policy is likely to provide floor to Chinese economy. Second, given PBoC's increasing reliance on the combination of three targeted monetary tools including open market operation, medium term lending facility and pledged supplementary lending, the chance of reserve requirement ratio cut may dim further.
▪ According to local newswire, China's brokerage firms have raised the minimum requirement for bond issuance of private owned companies as a result of recent rising credit defaults. The high-yield private names with domestic credit rating less than AA are facing increasingly difficult to find sponsor to access to the market.	▪ The tightening underwriting practice following the CSRC meeting with brokers in late April shows increasingly regulatory awareness about the credit risk in China's onshore market. Given China just expanded its macro prudential management of cross border financing to nationwide, Chinese private owned companies may shift their funding source to offshore market should they find difficulty in accessing to onshore market.
▪ The State Council announced in its regular meeting to carry out special supervision on the implementation of private investment policy to further expand the private investment. ▪ China will further lower the barrier and create an equal business environment to promote the private investment.	▪ The stabilization of Chinese economy in the first quarter was mainly driven by government led investment. The deceleration of private investment to a low of 5.7% in 1Q despite the rebound of headline investment showed private sectors remained cautious. This was also echoed by the falling index of both raw material and finished goods inventory sub-index from April PMI data. The sustainability of recent recovery will depend on the participation of private sectors.

▪ The job openings advertisement published by China's social security fund last week fuelled the speculation that the state pension fund may increase their holding of stocks soon.	▪ The regulatory hurdle for pension fund to invest in stock market has been cleared since August 2015 after the State Council published the guideline to expand investment scope for pension fund but cap the proportion of investments in stocks and equity funds to 30% of its total net assets. The latest hiring advertisement becomes the latest evidence that the pension is likely to start their investment in equity market soon.
▪ It is reported that HKMA and customer officials have tightened their scrutiny of fake trade invoicing. The mismatch between HK's export data and China's import data has been prominent since last December, prompting the HK officials to take such actions.	▪ As the international financial center with geographical advantage, Hong Kong is the most favourable place for China's outflow capital. Apart from HK's insurance products, fake invoicing trade is another prevailing way to meet the needs of capital outflow from the onshore market after China's officials implement tighter capital control. Though a thorough crackdown on fake trade invoicing is nearly impossible, we still expect that such scrutiny could help to further ease capital exodus from China.

Key Economic News	
Facts	**OCBC Opinions**
▪ **FX Reserve:** China's FX reserve in dollar term rebounded slightly to US$3.22 trillion in April, beating market expectation.	▪ The stabilization of FX reserve in March and April mainly benefited from valuation effect given dollar has weakened against major currencies while risk sentiment improved in global market. The disorderly capital outflows have paused in the past two months after concerns about the devaluation of Yuan eased. However, we think the trend of capital outflows have not been reversed yet given increasing overseas direct investment from Chinese companies as well as Yuan's ongoing depreciation against basket currency.
▪ **Trade:** China's export fell by 1.8% in dollar term in April but grew by 4.1% in RMB term. However, import fell sharply by 10.9% in dollar term. As a result, trade surplus widened to US$45.56 billion. ▪ China's imports from Hong Kong surged by 203.5% in April.	▪ The small decline of export growth in dollar term in April was in line with softening PMIs in advanced economies such as US and Japan. China's export to US and Japan fell by 9.3% and 11.8% respectively, overshadowing the steady exports to ASEAN and EU. Overall speaking, the April export data shows that China is still sensitive to global situation. The rebound in March may prove to be short-lived should global sentiment deteriorate further. ▪ Despite recovery of commodity prices in April, the still sluggish import prices also confirmed the still uncertain global outlook. Nevertheless, the more than 200% surge of imports from Hong Kong signals the trade between mainland and Hong Kong may be still distorted by capital outflows.
▪ **HK total retail sales** continued to decline in March, down 9.8% yoy. Value of retail sales totaled HK$ 34.7 billion, falling for the 13th straight month on yearly basis. For the first quarter of 2016, value of HK total retail sales decreased by 12.5% yoy.	▪ The decline of retail sales was broad-based. Decline in the luxury segment continued to pose a severe drag on HK retail sales. Value of sales of jewellery and watches contracted for the 18th straight month by 23.2% yoy in March, which was also the seventh consecutive double-digit contraction. Data signalled that the business environment is deteriorating in the retail sector amid weak inbound tourism. Dimmer economic outlook of HK and the uncertainty in asset market also dented local consumption sentiment. Gloomy prospect for Hong Kong's retail sector will as a result translate into more downward pressure on HK retail shop property market. More rental concession by the landlord and higher vacancy rate in

	core business district could also be expected.
▪ **HK Housing:** Overall residential property price dipped further by 7.31% yoy in March while volume continued to rebound to 4,494 units in April from 2,369 units in the previous month. On a yearly basis, annual decline of residential property transaction moderated significantly from 45% to 1% in April.	▪ By segment, transaction volume for housing units priced between HKD 3 million and HKD 5 million was mainly responsible for the rebound, which surged from 1,031 units to 1,914 units, up 86% mom. Transaction volume for housing units of other size also witnessed broad-base increase. All-in-all, given (1) China's slowdown, (2) dimmer HK economic outlook on weak inbound tourism, (3) and poor investor sentiments given the possible interest rate normalization in US, we may need more data points in order to conclude a genuine recovery in housing transaction.
▪ **Macau:** Gross gaming revenue declined for the 23rd straight month, down by 9.5% yoy in April to MOP17.34 billion. Nevertheless, starting from late last year, gaming revenue has been decreasing at a slower pace than previous months.	▪ Moving forward, as hotels are offering discounts on room rates in an attempt to attract customers, overnight visitors are expected to show sustainable growth. Given a gradual pick-up in the tourism sector coupled with the change of business strategies by the casino operators, we believe that the gaming sector has probably have bottomed out. Despite this, we still believe that gaming revenues are unlikely to retrieve positive growth over 2016 as the mass-market segment may not be profitable enough to cover the losses of VIP tables.

RMB

Facts	OCBC Opinions
▪ RMB index fell further to below 97 and hovered around 96.6 for most of all four trading days last week. RMB weakened against dollar in both onshore and offshore market last week as a result of rebound of broad dollar and weakening RMB index. ▪ In its latest monetary policy report, PBoC reiterated the role of RMB basket currency in the setting of daily fixing saying that the daily fixing will depend on two parameters including previous closing price at 4:30pm and the move of RMB basket currency.	▪ The fact that China continued to guide RMB weaker against its basket currency despite the rebound of dollar last week flagged the warning signal that China may prefer a weaker basket currency. This raised the concern that Yuan may have to depreciate faster against the dollar should the dollar regain strength in the global market, which also drove the Asian currencies weaker last week. ▪ Given PBoC's re-highlight of the role of basket currency in RMB's fixing setting, we expect the downside for RMB index is likely to be capped in particular when the broad dollar re-gain strength in the global market.

Liquidity

Facts	OCBC Opinions
▪ PBoC net withdrew CNY220 billion via open market operation last week.	▪ It shows PBoC is still cautious on liquidity management despite the correction of bond market.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Kam Liu
Kamyyliu@ocbcwh.com