Summary

The risk sentiment was generally shut down last week by People's Daily article from mystery "authoritative person". The article raised three imminent concerns though we think it came out at the right time. First, the prolonged L-shaped recovery comments signal the challenges could be more than expected. Second, the comments about the high leverage may signal a policy shift towards a tighter control. Third, the commitment to tackle overcapacity and zombie companies may lead to further volatility in the market. Nevertheless, we think this article served as a good timely reminder to market that China is unwilling to go back to old investment driven growth. The purpose of temporary demand boost is to buy more time for supply side reform, which is needed for a more sustainable growth in the medium term.

The April economic and financial data released over the weekend mostly disappointed, signalling the recovery is not one-way straight. Property market remains a key driver to growth in April. However, the increasing reliance of property market also raised concern about the sustainability of recovery, which is grounded on bubble. I guess **the key question market is asking whether we shall expect more easing following disappointed April data. We don't expect more easing in the near term for three reasons.** First, the April financial and credit data were distorted by temporary factors such as local government debt swap as well as sharp increase of fiscal deposit ahead of May tax regime change. Second, April economic activity readings are disappointed but not disastrous. Third, looking together with the People's Daily article, it shows government may have a higher tolerance for slightly slower growth to balance between growth and reform. We think the market sentiment may remain fragile in the near term given the diminishing easing expectation. But a short term pain is necessary for China to purse a long term gain at the current juncture. Market focus is likely to return to RMB this week after the USDCNH broke above 6.55 last Friday. However, we believe the switch from dollar anchor to basket anchor amid dollar strength is likely to keep the volatility in check.

Key Events and market talk	
Facts	**OCBC Opinions**
▪ The article by mystery "authoritative person" published in People's Daily rocked the market.	▪ A few key highlights from the article. 1) The recovery will be L-shaped, which will last more than 2 years. 2) Too early to cheer about the recovery as the current stabilization was mainly driven by investment led old growth model. 3) Both demand side and supply side measures are necessary to support growth, demand side was used to buy more time for supply side reform. 4) High leverage will lead to higher systemic risk. There is no need to support growth via higher leverage. 5) China should continue to tackle overcapacity and zombie companies in the next stage. ▪ To conclude, the article has addressed a number of concerns about how to balance economic growth and reform. It also shows top leadership is aware of the problem though there is concern about the divergent view within the top leadership. Overall speaking, we think this article may flag the possible policy shift going forwards.
▪ The European law makers voted overwhelmingly against to grant China market economy status. Under the non-market economy status, EU can use other methodologies to determine the normal value of Chinese goods in anti-dumping proceedings, instead of using China's domestic prices. This will usually lead to higher duties.	▪ China has been arguing that according to WTO Accession Protocol, China's non-market economy status will expire after 11 Dec 2016, which should automatically grant China the market economy status. The European parliament's decision is a blow to China's ambition. China has previously threatened that it will bring the case to the WTO dispute settlement body should no granted happen. This may spark fear about the potential trade dispute in the global stage amid the global economic slowdown.

Key Economic News	
Facts	**OCBC Opinions**
▪ **Financial and Credit data:** China's new Yuan loan increased by CNY555.6 billion in April, down from CNY1.37 trillion in March and missed market expectation. ▪ The increase of total social financing also slowed significantly to CNY751 billion in April from CNY2.34 trillion in March. ▪ The broad money supply M2 moderated to 12.8% in April, however, M2 continued to grow at a rapid pace of 22.9%.	▪ The general disappointed April financial and credit data were partially distorted by the local government debt swap as well as the spike of business tax recipients ahead of change of tax regime from 1st May. ▪ According to China's local rating agency CCXI, the issuance of local government debt hit a record single month high of CNY1.06 trillion in April. About 44.1% of local government debt were issued in form of private placement, which is a popular form to swap the existing debt. This led to the significant decline of existing loan. Based on PBoC's estimation, loans to local government funding vehicles continued to go up in April to at least CNY350 billion. However, majority of increment has been offset by the debt swap, which led to the slower growth of new Yuan loan. PBoC estimated new Yuan loan could have exceeded CNY900 billion in April excluding the impact of local government debt swap. This probably explained why the authoritative person flagged his concern about the credit expansion in People's Daily last Monday. ▪ The sharp decline of aggregate social financing was partially due to the decline of corporate bond issuance as well as on-going corporate de-leverage. Total net new issuance of corporate debt in April fell to CNY209.6 billion down from CNY698.6 billion due to massive cancellation of corporate bond issuance in April as a result of rising credit default. Meanwhile, total foreign currency loan under social financing fell by CNY70.6 billion signalling corporates continued to unwind their external debt despite stabilization in RMB. ▪ Last not least, the deceleration of M2 could be partially explained by the sharp increase of fiscal deposit, which increased by CNY931.8 billion, up significantly from CNY110.1 billion in March. The sharp increase of fiscal deposit was mainly the result of increasing local government debt issuance as well as the surge in business tax recipients ahead of change of tax regime from May. The sudden surge of fiscal deposit, which dragged down M2 growth by more than 0.6% in April, is likely to be temporary. ▪ Overall speaking, we think the credit and financial data in April remained fairly strong after excluding the impact of those temporary factors. Looking together with the article written by authoritative person in People's Daily last Monday, we don't see the rising easing expectation arising from the weaker than expected April financial and credit data. We think PBoC is likely to remain cautious in terms of credit expansion and liquidity management. The combination of OMO, MLF and PSL will continue dominate PBoC's policy tools.

▪ **Economic activities:** China's fixed asset investment growth decelerated to 10.5% in the first four months from 10.7% in the first quarter. Real estate investment accelerated further to 7.2% in the first four months from 1Q's 6.2% while private investment continued to decelerate to 5.2% from 1Q's 5.7%. ▪ Industrial production growth moderated to 6% in April from 6.8% in March. ▪ Retail sales grew by 10.1% in April, down from 10.5% in March.	▪ All three economic activity data missed market expectation showed that Chinese recovery is unlikely to be a straight line. The moderation of retail sales growth is mainly driven by the slowdown in car sales due to the implementation of tougher emissions standard in Eastern China. ▪ Real estate market continued to be the major driver to China's growth in April. Property sales value increased by 55.9% yoy in the first four months while real estate investment grew by 7.2% yoy. However, the concern about the sustainability of property market boom has raised concern about China's growth prospect given the increasing reliance of recent recovery on property market. ▪ What's more, the further deceleration of China's private investment to 5.2% in the first four months flagged the warning signal that the recovery may not be sustainable without the participation of private sectors.
▪ **HK economic growth** moderated significantly from 1.9% to 0.8% yoy in 1Q 2016.	▪ Private consumption increased at a slower pace of 1.1% yoy amid fear of job losses as well as concern about domestic economic outlook. Investment slackened further from -9.4% yoy to -10.1% yoy. Signalling low confidence from enterprises. In addition, total exports of goods continued to contract, slumping by 3.6% yoy after the drop of 0.5% yoy in previous quarter. Exports of services also decrease by 4.9% yoy, among which decline in export of travel services enlarged to 13.3% yoy due to unstable political environment of HK, China's anti-corruption campaign as well as the stronger HKD. Looking forward, we expect the HK economy to continue to face headwind amid weakening tourism activities, soft external demand and depressed local sentiment.
▪ **Macau's** residential property transaction volume picked up by 63.5% mom to 497 units in March, the highest in recent three months.	▪ Average monthly residential property transaction volume recorded 405 units in 1Q, still lower than the average 498 units last year. As housing transaction volume rebounded in March, new residential mortgage loan (RML) approvals increased by 31.4% mom to MOP2.96 billion in the same month. However, on yearly basis, it still plunged 39.85%. Looking ahead, uncertainty over domestic economic transition as well as expectation on slow recovery of the gaming sector continued to dent local sentiment. Therefore, we continue to believe that housing transaction will remain low around 500 units in 1H while private housing price to fall by around 10% yoy by end of this year.

RMB	
Facts	**OCBC Opinions**
▪ RMB index rebounded last week to around 97 level. However, RMB weakened against the dollar in both onshore and offshore market with the USDCNH broke above 6.55 as a result of broad dollar rally in the global market. ▪ The onshore-offshore exchange rate gap widened again to more than 200bps.	▪ It seems last week's market movement confirmed our view that China may switch between dollar anchor and basket anchor depending on the dollar movement. The rebound of RMB index last week amid dollar strengthen shows that PBoC may have switched to basket anchor to contain volatility. Nevertheless, it is unlikely to reverse the trend of RMB's mild depreciation against the dollar should dollar continue to gain in the global market. ▪ The widening gap between onshore and offshore RMB showed the increasing bearish view from offshore investors following the weaker than expected China April trade data.

	However, the upside for USDCNY was capped in the onshore market due to increasing dollar settlement needs from corporate. The gap may remain in the near term.

Liquidity	
Facts	**OCBC Opinions**
▪ PBoC net withdrew CNY140 billion via open market operation last week.	▪ It shows PBoC is still cautious on liquidity management. We think the combination of OMO, MLF and PSL are still preferred liquidity management tools.

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