Summary

PBoC kept its RMB index in a tight range last week. Frankly speaking, the fact that we are able to forecast the daily USDCNY fixing more accurately shows that RMB has been more predictable than unpredictable after PBoC has been following its revised fixing mechanism closely in the past few weeks. As such, the 5-year high of daily USDCNY fixing last Wednesday did not induce fresh rounds of volatility though media started to paint another negative outlook on RMB. As long as China follows its currency fixing mechanism, we think the near term risk of one-time devaluation is low.

In addition to RMB, another important event last week was that China re-elaborated its prudent monetary policy and proactive fiscal policy tone last week. We think the chance of broad based monetary easing has been ruled out in the near term as long as China's capital market remains steady. Targeted measures such as open market operation, MLF and PSL are still most preferred measures by PBoC. On fiscal side, given the increasing constraints of monetary policy following aggressive easing in 2015, fiscal policy is likely to play a leading role to stabilize Chinese growth this year.

Last but not least, the detailed rules released by PBoC on investment in China's onshore interbank bond market is likely to attract more capital inflows from medium to long term investors, which is unlikely to be disrupted by short term RMB volatility. Interestingly to note, the widening gap between export to China reported by Hong Kong and import from Hong Kong reported by China signals that capital outflow pressure remains. Given the USDCNY fixing is expected to break above 6.5700 this morning, China's strategy to contain RMB volatility will be important to watch this week.

Key Events and market talk	
Facts	**OCBC Opinions**
▪ PBoC reviewed its monetary policy for the past year in its latest report and said it had no choice but cutting interest rate in June 2015 and injecting liquidity in early 2016 in reaction to two separate sell-offs in equity market as there is no alternative way to prevent from systemic risk. ▪ Meanwhile, PBoC expects the M2 growth to slow further due to distortion from past liquidity support to equity market. ▪ PBoC reiterated that it will keep its prudent monetary policy intact.	▪ We think the latest article from PBoC set the tone for the monetary policy in the coming quarters and we see two implications. First, the warning of further slowdown of M2 growth distorted by previous liquidity support to equity market signals the slowdown in financial and credit data in the coming months is unlikely to be the trigger to further easing. We think targeted easing is still the preferable policy tools to a broad-based easing. Second, financial stability will be one of the important pre-conditions for aggressive monetary easing. Should China's capital market remain relatively stable, there is no urgency for PBoC to announce more easing measures. ▪ To conclude, we see low probability of broad-based easing such as reserve requirement ratio cut and interest rate cut in the near term. Targeted measures such as open market operation, MLF and PSL are still most preferred measures by PBoC.
▪ The Ministry of Finance estimated that China's government debt to GDP ratio was only slightly above 40% including both central and local government liability. As such, the MOF said there is still room for China to increase the government leverage to help lower corporate's leverage.	▪ It clearly confirms the tone of proactive fiscal policy. Given the increasing constraints of monetary policy following aggressive easing in 2015, fiscal policy is likely to play a leading role to stabilize Chinese growth this year.
▪ PBoC published detailed guidance on investment in China's onshore interbank bond market by offshore financial institutions.	▪ There will be no quota limit for qualified offshore financial institutions. However, for offshore financial institutions, which access to onshore interbank bond market via QFII and RQFII channels, they still need to comply with QFII/RQFII regulation such as quota. ▪ Offshore investors freely decided to bring in RMB or foreign currency. For repatriation, offshore investors should maintain

	basic similar currency structure for inflows and outflows with less than 10% deviation, meaning they can only repatriate in form of USD if they inject the USD to onshore bond market in the first place. ▪ Again, given the extreme low participation of foreign investors in China's bond market, which is less than 2%, we do expect more inflows from offshore bond investors despite concerns about the RMB volatility and credit quality. ▪ We do not expect the recent RMB volatility will hinder interests from medium to long term investors. Judging by the example of Indonesia and Malaysia, the foreign ownership of their bonds remain sizable and steady despite recent spike of currency volatility. As such, we see huge room for China to develop its onshore bond market with more participation of foreign investors. This may eventually alleviate pressure for banks and help transfer some risks out of banking sectors.
▪ China sold its Yuan-denominated sovereign bond in London, first outside China and Hong Kong. The 3-year offshore government bond was priced at 3.28%, higher than that in the onshore market for the same tenor.	▪ The issuance following the issuance of PBoC bill in London last year will further help China build RMB yield curve in the offshore market. This suggests China's commitment to promote RMB Internationalization remains unaffected by the recent volatility in the currency market.
▪ The HKEX will launch four new deliverable RMB futures this week including EURCNH, JPYCNH, AUDCNH and CNHUSD.	▪ The USDCNH deliverable futures contract has become popular in Hong Kong for investors to hedge risks as a result of increasing currency volatility. Given most foreign investors are not allowed to tap the onshore FX market despite further opening of onshore interbank FX market. Such RMB currency futures would enable the foreign investors from Eurozone, Japan and Australia hedge their FX risks and increase RMB assets' appealing to a wider range of investors. This will pave way to further push the RMB internationalization.
▪ Moody's downgraded Macau government's credit rating by one grade to Aa3 and assigned a negative outlook.	▪ Moody's expects Macau's economy will continue to contract during 2016 and 2017 albeit at a slower pace. Moody's also opined that Macau's economic transition will make the growth sensitive to shifts in external demand. However, recent data shows signs of pick up in the city's tourism activities thanks to new hotel openings since last May. And the tourists' growth is broad-based in terms of major sources, including Mainland China. As a result of increased tourists, the mass market segment of gaming sector is expanding with its share increasing to 40%, which may grow further on the back of the expansion of Asian middle class. The city is planning to build a theme park and introduce international sporting events. Adding that more hotel and casino projects will be completed in the coming 1-2 years, the tourism sector is set for gradual recovery. Though weak tourism expenditure and government's restriction on gambling table growth will hinder the rebound of the gaming sector, we still believe that the gaming revenue will fall at a much slower pace this year by 5% yoy. Moreover, after prolonged slowdown, global economy and external demand are more likely to recover than to fall further in the long-run. Therefore, downward risks on Macau's economy are limited. By end of 1Q, Macau's fiscal reserve is estimated to be MOP436 billion, equivalent to 59 months of government expenditure in the 2016/2017 fiscal year. All in all, we believe that Macau's economy could retrieve growth next year after contracting by another 1.2% in 2016 and will stabilize with modest growth in the long term.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's industrial profit for firms with annual revenue more than CNY20 million decelerated sharply to 4.2% in April down from 11.1% in March. ▪ Nevertheless, industrial profit grew by 6.5% in the first four months, reversing decline trend in 2015.	▪ The deceleration of industrial profit in April was mainly attributable to slowdown in electronics, electricity and auto industries. ▪ However, profits in high-tech industries continued to expand at a rapid pace of 21.6% yoy in April. ▪ The other bright spot came from finished goods inventory, which fell by 1.2% yoy, the first decline in recent years. This suggests the easing pressure from high inventory.
▪ **HK exports** value declined for the 12th consecutive month albeit at a slower pace, falling by 2.3% yoy in April. Meanwhile, imports value (HK$ 316.3 billion)'s decline also narrowed to 4.5% yoy in April, improving the trade deficit to HK$31 billion.	▪ The prolonged tumble of HK's export is attributed to sour external demand. Moving forward, we expect the decline in exports and imports to moderate in Hong Kong on the back of rebounding demand from EU and some Asian markets. Notably, exports to Mainland China slipped by 4.8% yoy, whereas imports from HK reported by China's customs jumped significantly by 203.5% yoy. The prominent mismatch in data prints points out that pressure of capital outflow from the onshore market is still alive. We will keep monitoring trade data across border to assess whether HKMA's and HK customs' crackdown on fake trade invoicing from China has taken effect.
▪ **Macau**'s inbound tourists fell by 3% yoy in April, partly due to tumble of visitor's arrival from Hong Kong.	▪ As the Easter holidays came in March as compared in April last year, the decline in visitor arrivals was merely a result of holiday effects. On a positive note, overnight visitors increased for the ninth straight month and rose by 5.6% yoy thanks to more favorable room rates. Notably, the number of visitors from other major sources, including Mainland China, posted strong growth. The rosy data suggest that once the effect of Easter Holiday dissipates, visitor arrivals may be able to see renewed annual growth.

RMB	
Facts	**OCBC Opinions**
▪ PBoC maintained the RMB index in a tight range. As a result, the USDCNY fixing has been floating along the global dollar movement. The USDCNY fixing hit five-year high of 6.5694 last Wednesday, partially raised concerns about the renewed RMB depreciation pressure. H	▪ Unlike early January this year, the renewed concerns about RMB depreciation amid dollar strength did not induce fresh rounds of volatility as PBoC has been following the new fixing mechanism closely. ▪ Frankly speaking, we believe RMB has been more predictable rather than unpredictable. As such, we don't expect any significant devaluation in the coming quarters despite the risk of stronger dollar. ▪ Meanwhile, the occasional intervention is likely to keep volatility in check.

Liquidity	
Facts	**OCBC Opinions**
▪ The impact of tighter dollar liquidity in the onshore market was not only limited to onshore swap but the offshore HKD swap as well. ▪ Nevertheless, the dollar liquidity has somewhat	▪ The dollar liquidity has been tighter in the onshore market since mid-May after the Fed released more hawkish than expected FOMC minutes. The dollar tightness was also the result of lock-up of dollar liquidity by central bank via 20%

improved in the past few days.	reserve requirement ratio for any long dollar forward position as well as intervention in the forward market. ▪ The USDCNY swap points have moved to the left across the curve as a result of tighter dollar liquidity. This also drove the HKD swap points to the left as some Chinese banks using HKD as alternative source to dollar given the still tight CNH funding.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Kam Liu
Kamyyliu@ocbcwh.com

Co.Reg.no.:193200032W