Highlights:

China's capital market continued to re-price the policy risk arising from the de-leverage campaign. Both equity and bond market extended their losses with 10-year government bond yield rose to 3.56%. The wave of regulatory tightening has extended to local government as well as insurance and security sectors from banking sectors. The new regulation 50 from Ministry of Finance to standardize local government funding behaviour as well as Shenzhen security regulator's curb on security firms' asset pooling business are two latest additions to China's de-leverage story. The sharp correction of commodity prices last week following MOF's regulation 50 shows that China's policy tightening may become global problem.

For regulation 50, we see two possible near term impact. First, the credit spread for LGFV bond may widen further in the onshore although the impact on offshore LGFV bond is limited due to limited supply and poor liquidity as majority of bonds are held by Chinese investors. Second, the rebound of China's fixed asset investment since the second half of 2016 was partially fuelled by the rapid expansion of PPP projects. The tightening on PPP may slow down the investment from PPP projects, which may eventually lead to a slower growth in the coming quarters. This reinforces our view that China's growth has peaked in 1Q and we do expect growth to slow gradually in the next few quarters.

The only asset class remains relatively stable last week in China is RMB. The USDCNY continued to be traded in a narrow range although the pair broke 6.90 last Friday afternoon. Nevertheless, RMB index rose slightly to end the week at 93 as a result of weaker dollar index. Macro's decisive victory in French President Election is likely to cap the upside for USDCNY and the fixing is expected to remain below 6.90 this morning. China's FX reserve rebounded for the third consecutive month in April. The recovery of China's FX reserve was mainly due to valuation effect, benefiting from the correction of broad dollar in April. Given unwind of strong dollar expectation after Trump's tax reform plan which did not include border adjustment tax element, we think RMB is likely to remain stable in the coming months. This should further warrant the stability of China's FX reserve in the next few months.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China's Ministry of Finance unveiled the regulation 50 as supplement to regulation 43 issued in 2014 and 88 issued in 2016 to further standardise the local government funding behaviour.	▪ Although the regulation 50 from MoF is not that long as compared to regulations from CBRC, it still presses local governments to scrutinize their funding in four areas including debt guarantee, market-based issuance, information disclosure and public private partnership (PPP) ▪ First, MoF will start another round of investigation on the outstanding of local government debt guarantees. Local governments were asked to correct their improper debt guarantees behaviour by end of July 2017. ▪ Second, the local government funding vehicle (LGFV) financing will be market based. Local governments are not allowed to use charitable assets, reserve lands and expected income from reserve land as source of debt repayment. In addition, LGFV also needs to fully disclose information to investors when they issue bonds in both onshore and offshore market that it is not considered as local government debt. ▪ Third, on PPP, local governments are allowed to set up investment funds together with private investors, however, local governments are not allowed to borrow to set up the funds to ban PPP from becoming alternative channels for local governments to leverage. ▪ Implications: we think the latest measures are part of China's efforts to de-leverage the economy, which is good in the long run. However, we see two possible implications from the new regulation in the near term. ▪ First, we might see further correction in LGFV bond space. The LGFV credit spread has widened recently as a result of rising volatility in China's bond market. The spread between 5 year AA+ LGFV bond and 5 year Government bond in the onshore market has widened to about 170bps as of early May from the

	low of 80bps in mid-November last year. The spread may widen further as a result of further regulatory tightening. However, the impact on the offshore LGFV dollar bond may be limited due to limited supply and poor liquidity as majority of bonds are held by Chinese investors. ▪ Second, the rebound of China's fixed asset investment since the second half of 2016 was partially fuelled by the rapid expansion of PPP projects. The tightening on PPP may slow down the investment from PPP projects, which may eventually lead to a slower growth in the coming quarters. This reinforces our view that China's growth has peaked in 1Q and we do expect growth to slow gradually in the next few quarters.
▪ China Development bank denied the market talk that the policy bank is going to suspend the issuance of policy bonds.	▪ The suspension of issuance of policy bank bond is considered as one of the leading signals that liquidity situation might have gone to extreme and room for further policy tightening may be limited. The denial of the news shows that an moderate de-leverage is likely to remain and overall liquidity is expected to remain tight in the coming weeks.
▪ Policy de-leverage stories continued to dominate last week with the latest news from security regulator shows that security firms are banned from doing asset pool business in Shenzhen to curb duration mismatch.	▪ Both banking regulators and security regulators have targeted the complex multi-layers structure created to increase leverage to enhance returns. Going forwards, "see-through" is likely to be the guideline for all wealth management products to be able to track the underlying risks.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's FX reserve rebounded by US$20.4 billion in April to US$3.0295 trillion, up for third consecutive month.	▪ The recovery of China's FX reserve was mainly due to valuation effect, benefiting from the correction of broad dollar in April. We still expect a very mild capital outflows in April though the net capital flow is likely to gradually return to equilibrium level as a result of stable currency. Given unwind of strong dollar expectation after Trump's tax reform plan which did not include border adjustment tax element, we think RMB is likely to remain stable in the coming months. This should further warrant the stability of China's FX reserve in the next few months.
▪ Hong Kong's retail sales grew by 3.1% yoy in March, firs positive growth since Feb 2015.	▪ The recovery was mainly supported by the recovery of visitor arrivals from mainland China, which increased by 10.4% yoy in March, as well as improving local consumption demand.
▪ **Macau:** Gross gaming revenue (GGR) resumed upward momentum and grew 16.3% yoy to MOP20.16 billion in April.	▪ New resorts had successfully drew both high rollers and casual gamblers. Additionally, the housing frenzy and economic stabilization in Mainland China has reintroduced stream of VIP spenders from Mainland. As China's economy is expected to sustain its growth traction in 1H, we may see rosier data out of the VIP segment for the months to come. Meanwhile, the mass-market segment will likely continue to grow gradually given a moderate rebound in tourism activities. However, a waning base effect, an expected slowdown in China's growth in 2H, and a stronger MOP, are likely to shrug off some upward risks on the gaming sector. All in all, as GGR is likely to grow faster than previously expected in 1H, we revise our forecast for 2017's gaming revenue growth on a yearly basis from 5%-7% to around 10%.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY ended up the week above 6.90 last week although RMB index recovered slightly to 93.	▪ The USDCNY was still traded in a narrow range although the pair broke 6.90 last Friday afternoon. However, the weaker dollar index after Macro's decisive victory in French President Election is likely to cap the upside for the USDCNY. We expect the USDCNY fixing today to remain below 6.90.

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