Asia
China

Strategy
China Equity Strategy

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Strategy Update

Five things you need to watch in June

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We suggest investors watch these five things closely in June

1. FOMC meeting: At 2am HKT on 18 June (i.e. 2pm EST on 17 June), the Fed will release the June FOMC meeting statement. Our US economist maintains the **base case expectation that the first Fed rate hike will be seen at the 16-17 September meeting**. However, with the stronger-than-expected labor and retail sales data in the past few days, we expect global investors to scrutinize the June statement next week to better understand the latest Fed stance and assess the likelihood of the lift-off in September. On equity performance, we note EM and Asia Pacific equities underperformed global markets and have lost 8.3% and 7.7% since end-April on the back of rising UST yield, likewise H-shares (MSCI China fell 8.9%).

2. HK electoral reform bill vote: On Wednesday 17 June, the Legislative Council of Hong Kong will vote on the electoral reform bill. The debate and voting process **is likely to drag on until next Thursday or even Friday** before the result comes out and the chance of passing the bill does not seem high at the moment, as suggested by recent comments from top HK officials. We think this event may **continue to weigh on investor sentiment and heighten market volatility**, especially if the bill is rejected next week. See: Three reasons why H-shares lagged; near-term consolidation to extend, published on 10 June.

3. A new round of A-share IPO funds lock-up: A new round of 25 A-share IPOs will kick in next week and may temporarily impact onshore liquidity conditions. According to a Bloomberg survey, **around Rmb7trn funds may be locked up** for the upcoming IPO subscriptions, the highest level since China resumed IPOs in 2014. **The single day peak of Rmb5~6trn lock-up will be seen on Friday 19 June,** due to the mega-size IPO by one of the largest Chinese brokers, and the funds will be released from Wednesday 24 June, as Monday 22 June is the Dragon Boat Festival public holiday.

4. Rising Chinese market rates before semi-annual ends: We notice the **onshore interbank bond yield has been creeping up across the curve since end-May**, as near-end 7-day repo and 3-month SHIBOR edged up to 2.1% and 2.9% respectively, after almost two months of continuous decline, and long-end 10-year CGB and AAA corporate bond yields climbed to 3.6% and 4.7% respectively. On one hand, we find **it's a seasonality that Chinese market rates generally spike up at semi-annual ends** (Figure 1) as a lot of cash settlement happens around this time-point; rates may shoot up further from here if history is a guide. On the other hand, **recent surging local government bond issuance** under the debt swap program and **local news reports about PBoC liquidity withdraw** of over Rmb100bn via repo transaction may have also played a role.

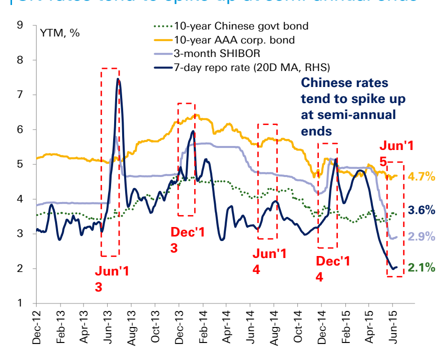
5. An imminent PBoC rate cut? Our economist expects another PBoC rate cut as soon as June to contain real interest rates. Indeed, comparing 10-year US Treasury yield and recent PBoC rate cuts, it seems **PBoC rate cuts have been closely following the surge in UST yield since 4Q14** (Figure 2). We notice most recently that the UST yield has shot up another 36bps in the past two

Five things you need to watch in June

Date (HKT)	Event
17-19 Jun	HK electoral reform vote
18 Jun	June FOMC statement
19 Jun	A-share IPO funds lock-up
end-Jun	Seasonal spike up of Chinese market rates
Jun	Potential PBoC rate cut

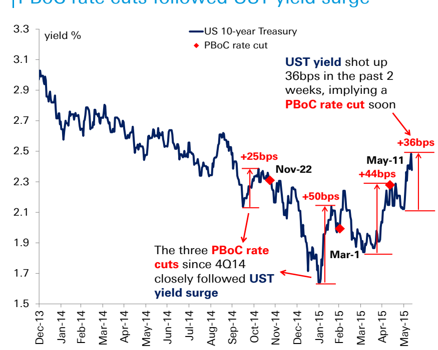
Source: Deutsche Bank Strategy Research

CN rates tend to spike up at semi-annual ends



Source: Wind, Deutsche Bank Strategy Research

PBoC rate cuts followed UST yield surge



Source: Bloomberg Finance LP, Deutsche Bank Strategy Research weeks, echoing our economist's expectation of an imminent PBoC rate cut in June. A potential rationale for the phenomenon is that **PBoC may have sold UST before its rate cut announcement to raise ammunition** (US dollar), so the authorities could **maintain a stable RMB exchange rate vs. the USD** later, despite potentially rising capital outflows amid a narrowing China-US yield carry. Note we reiterate our view that monetary loosening is widely expected by market participants and system liquidity is already quite abundant; **we would like to see more expansionary fiscal measures** to create credit demand in the real economy and therefore raise the outlook of economic fundamentals.

Market consolidation may extend in the near term

We continue to expect further market consolidation in the near term and suggest institutional investors consider adding downside protection via derivatives (e.g. putting on a collar option strategy) to weather the possible near-term consolidation while keeping core holdings to gain from potential medium-term upside.

Figure 1: It's a seasonality that Chinese market rates generally spike up at semi-annual ends; recently we have found that onshore interbank rates have been creeping up across the curve

Source: Wind, Deutsche Bank Strategy Research

Figure 2: Recent PBoC rate cuts have been following UST yield surge since 4Q14; most recently UST shot up 36bps in the past two weeks, implying an imminent PBoC rate cut in June and echoing our economist's expectation

Source: Bloomberg Finance LP, Deutsche Bank Strategy Research

Appendix 1

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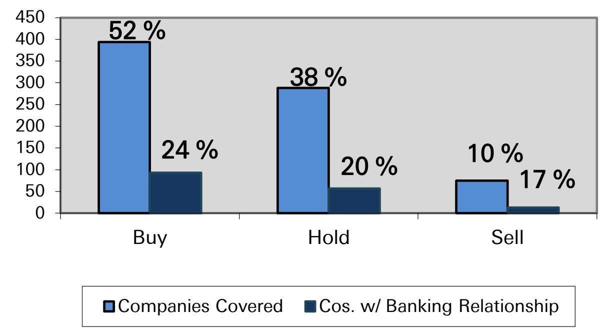

Asia-Pacific Universe

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