

MONTHLY HIGHLIGHTS

- HKEX's USD/CNH futures contract had an average daily volume, or ADV, of 2,479 contracts (US\$248 million notional) in March 2016. Open interest was 28,215 contracts (US\$2.8 billion notional) as of the end of March 2016.
- HKEX's Chief China Economist, Dr Ba Shusong, thinks the latest recovery in the Mainland real estate sector differs from previous ones and the real estate sector's contribution to GDP has peaked.
- In the Expert Corner, Dr Wei Wang (also known as Steve) of Bank of China International discusses the emergence of euro-denominated Chinese bonds as a seemingly new bond class for global credit investors. He says sustained demand from European investors is critical for the segment's continued growth.

FROM THE CHIEF CHINA ECONOMIST'S VANTAGE POINT**RECOVERY OF MAINLAND REAL ESTATE SECTOR – FEATURES AND TRENDS****Dr. Ba Shusong, Chief China Economist, HKEX****Executive Summary:**

Under a spate of policy stimulus, there have been signs of gradual recovery in the Mainland real estate sector since 2015 Q4. Both first-tier and some of the second-tier cities saw increases in property transactions and a rise in property prices. The trend has been evident in the past two months too, with the real estate sector warming up most quickly in Shenzhen, Shanghai and Beijing. Although the down payment reduction and tax incentive announced in February 2016 does not apply to first-tier cities, the relaxed policy has an indirect stimulating effect on properties in those cities as manifested in the increasing speed of completion of transactions and property owners' optimism about property prices.

This new round of recovery in the Mainland real estate sector differs from previous ones. Firstly, the demand will come mainly from an increasing need for better properties, driven by: (i) genuine resident demand, (ii) policy support and (iii) improved supply in the high-end market. Secondly, government measures have stimulated investment demand in first-tier cities.

Looking ahead, in an environment of generally relaxed policies, there could be some policy tightening in first-tier cities. In terms of market performance, third-tier cities have fared well so far in 2016, but performances varied notably. In macroeconomic terms, the real estate sector's contribution to GDP has peaked. It is now a source of downward pressure on the Mainland investment market.

1. The real estate sector in some Mainland cities is quickly recovering

In January 2016, after consecutive declines in the past 15 months, the price of new flats in 70 large- and medium-sized cities increased for the second consecutive month. The month-on-month change in January 2016 was 0.3 per cent after a 0.2 per cent gain in December 2015. Property prices have seen a modest rise for nine consecutive months. Although the rise has been modest, it suggests that fundamentals of the Mainland real estate sector are recovering, and that policies supporting reasonable property demand have been effective.

It is evident that property prices vary between cities. In January 2016, property prices in first-, second- and third-tier cities rose 23.9 per cent, 2.5 per cent, and -1.6 per cent respectively year-on-year. As supply in first-tier cities is relatively tight, the price increases were highest in those cities. In contrast, most third-tier cities are under pressure to sell properties, targeting trading volumes at the expense of potentially lower prices. In 2016, the majority of third-tier cities are expected to focus on "reduced inventory" of unsold properties. Property prices in third-tier cities may stop plummeting after some unsold properties have been sold.

In January 2016, the prices of flats of sizes below 90 square metres, 90-144 square metres and above 144 square metres rose 1.1 per cent, 1.3 per cent and 0.8 per cent respectively. In recent months, there was a notable rebound in the prices of flats of 90-144 square metres. In the past two months, their price surge exceeded that of other flats. It indicates the increasing need for better properties has boosted the prices of large and medium-sized flats.

(continued on page 9)

Chart of the Month: Foreign Holdings of China's Onshore Bonds

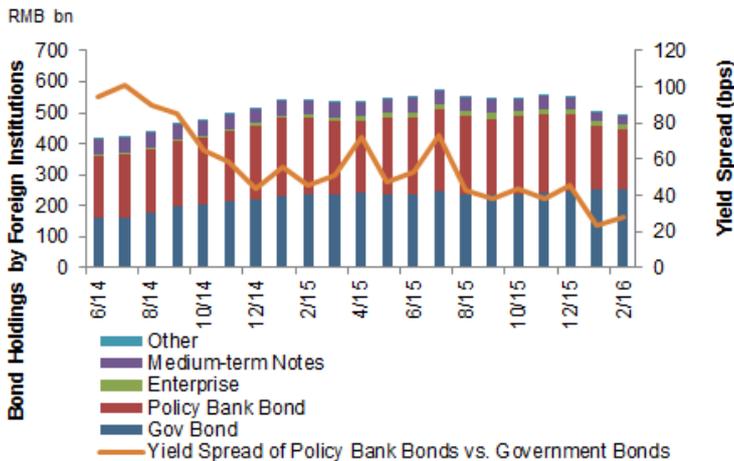


Fig 2: Macro-Economic Climate Index

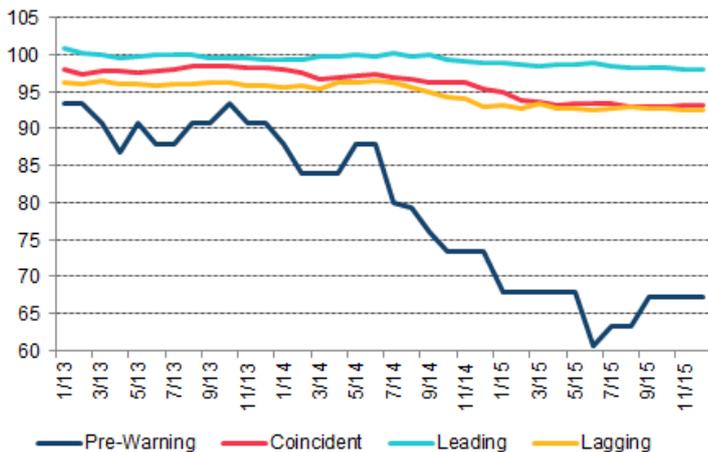


TABLE 1

China Key Economic Indicators	Current	Prior	Chg	Next Release Date
Real GDP (yoy %)	6.8	6.9	↓	04/15/2016 10:00
CPI (yoy %)	1.8	1.6	↑	04/11/2016 09:30
PPI (yoy %)	-5.3	-5.9	↑	04/11/2016 09:30
Industrial Production (yoy %)	5.9	6.2	↓	04/15/2016 10:00
FAI (yoy %)	10	10.2	↓	04/15/2016 10:00
Foreign Investment (yoy %)	3.2	-5.8	↑	04/08/2016 04/12
CFLP Manufacturing PMI	49	49.4	↓	05/01/2016 09:00
PBOC Bankers Confidence Index	37.9	40.6	↓	TBC
PBOC Bankers Loan Demand Index	56.8	56.7	↑	TBC
CEMAC Leading Economic Index	98.12	98.12	↔	04/05/2016 04/08
Exports (yoy %)	-11.2	-1.4	↓	04/13/2016
Imports (yoy %)	-18.8	-7.6	↓	04/13/2016
M2 Money Supply (yoy %)	14	13.3	↑	04/10/2016 04/15
Retail Sales (yoy %)	11.1	11.2	↓	04/15/2016 10:00
Consumer Confidence Index	111.3	114.9	↓	04/27/2016 09:45
Regulated Reserve Ratio (%)	17.5	18	↓	Infrequent
Official Foreign Exchange Reserves (USD bn)	3230.89	3330.4	↓	04/07/2016
Three-Month SHIBOR (%)	2.86	3.01	↓	Continuous
10-Year Gov't Bond Yield (%)	2.89	2.83	↑	Continuous
CNY/USD Exchange Rate	6.549	6.563	↓	Continuous

CHART OF THE MONTH

- Foreign holdings of China's onshore bonds declined for a third consecutive month in February 2016. They fell by RMB10.4 billion to RMB495.1 billion, extending a record drop of RMB48.7 billion in January 2016, WIND data shows. Meanwhile, foreign institutions have gradually increased the proportion of government bonds in their portfolios while decreasing the role of policy bank bonds, partly due to the further narrowing of the spread between the yields of two bond groups. As shown in the chart, the yield spread for policy banks and government bonds decreased from 100 bps in mid-2014 to 30 bps recently. Foreign ownership of onshore RMB bonds currently stands at 1.8 per cent.

REGULATORY/POLICY DEVELOPMENTS

- China is studying a "Tobin tax", as it could be a new policy tool to curb capital outflows, said Yi Gang, vice governor of the People's Bank of China (PBOC) on 19 March 2016. The study may stem from the significant speculation in the RMB market from December 2015 to January 2016. If fully implemented, the Tobin tax would make short-term speculative flows more expensive.
- The PBOC is considering a new interest rate mechanism that would include a band based on the deposit and lending facilities it offers to commercial banks. PBOC vice governor Yi Gang said a new mechanism was needed "to enhance guidance of market rates and the effectiveness of monetary policy".

MACRO ECONOMIC UPDATE

- China's US\$3.2 trillion foreign exchange reserves declined by US\$28.6 billion in February 2016, the smallest decrease since June 2015. The smaller decline was attributed to a firming RMB that required less defensive action by the authorities, and assurances from the authorities that the economy does not face a so-called hard landing.

KEY RESEARCH REPORTS/CONFERENCES

- Overall debt, particularly in the corporate sector, is too high in China, and sturdier regulation and deeper capital markets are needed, said central bank governor Zhou Xiaochuan in a speech at the China Development Forum in Beijing on 20 March 2016. Corporate debt in China is 160 per cent of gross domestic product, a level that Zhou calls problematic in terms of macroeconomic risk.

RMB FX MARKET DYNAMICS

OFFSHORE USD/RMB

- In March 2016, CNY fixings moved between 6.4612 and 6.5490, and CNH was trading 1.4 per cent higher vs the US dollar from a month ago, reflecting the upward adjustment in CNH recently as the PBOC sought to dampen CNH outflows.
- The one-month OTC USD/CNH options' implied volatility declined sharply from 7.12 per cent to 5.24 per cent in March 2016 as the PBOC used rhetoric to tone down market expectations for further RMB depreciation and released a draft plan for a Tobin tax on FX transactions to deter new RMB shorts.

Fig 3: Onshore/Offshore RMB Price Range

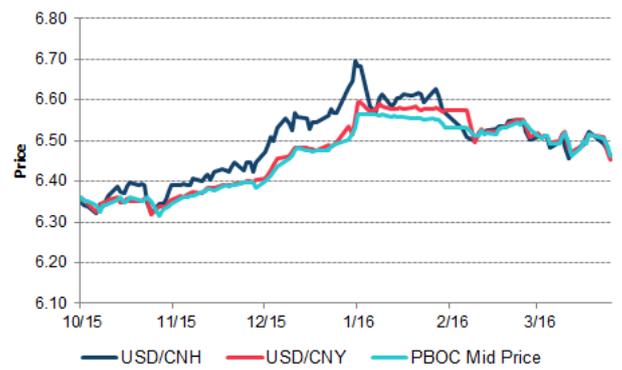


Fig 4: Implied Volatilities of OTC USD/CNH ATM Options

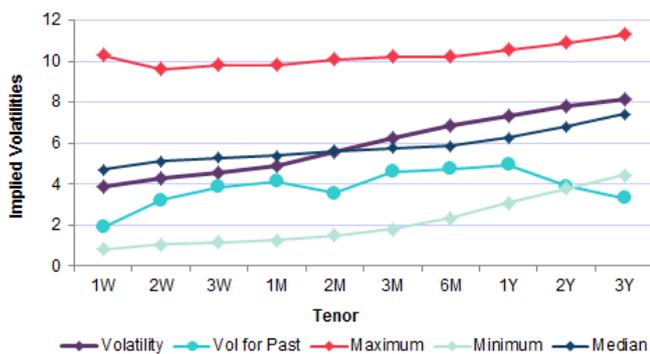
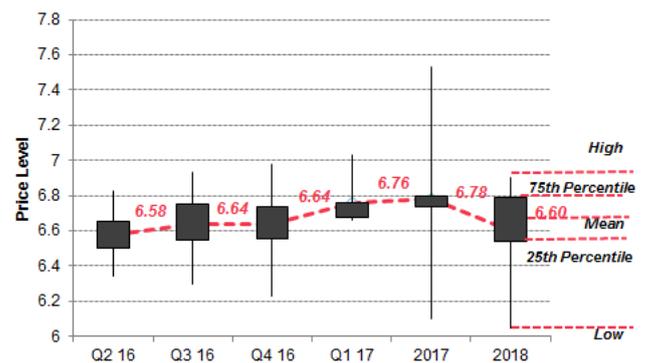


Fig 5: Market Forecasts for the Level of USD/CNH



HKEX'S USD/CNH FUTURES

PRODUCT HIGHLIGHTS

- HKEX's USD/CNH futures contract had an ADV of 2,479 contracts (US\$248 million notional) in March 2016.
- Trading volume was high in the Jun-16, Dec-16, and Mar-17 contracts, which accounted for 56 per cent of total volume in March 2016. Open interest was also concentrated in the Jun-16, Dec-16, and Mar-17 contracts, which accounted for 77 per cent of total open interest at the end of March 2016.

Fig 6: USD/CNH Futures Turnover and Open Interest



Fig 7: HKEX USD/CNH Futures Contract Provides Best Liquidity in Volatile Market

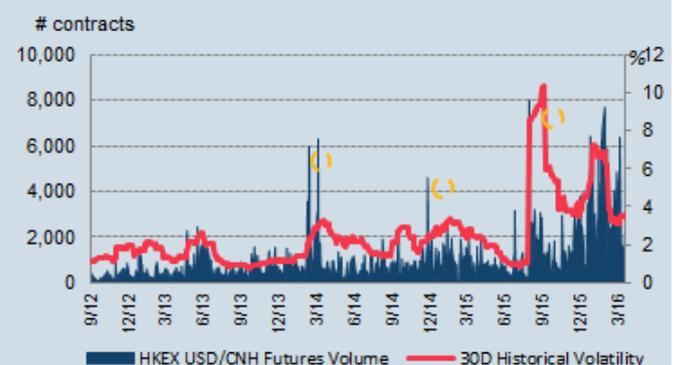


Fig 8: Breakdown of Volume by Contract Month (3/2016)

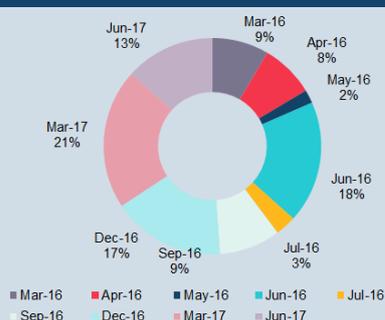
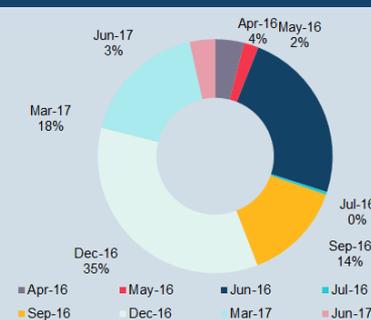


Fig 9: Breakdown of OI by Contract Month (31/3/2016)

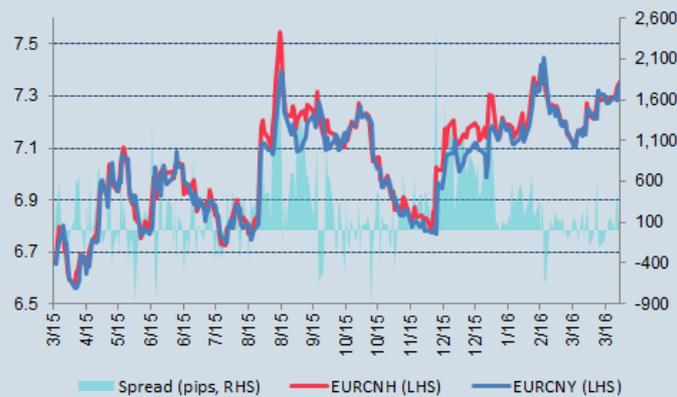


OFFSHORE RMB AGAINST OTHER CURRENCIES

EUR/CNH

- The CNH was trading 3.4 per cent lower against the euro, or EUR, in March 2016 from a month ago as Eurozone consumer prices continued to fall (they were down -0.1 per cent in March, which was a slightly slower pace than in February, when they fell 0.3 per cent).
- The historical volatility decreased significantly, as it fell to 10 per cent in March 2016.
- On the FX radar, the fundamental factor was well below its historical average, while the risk and sentiment factors were above their historical average.

Fig 11: Offshore/Onshore Spread



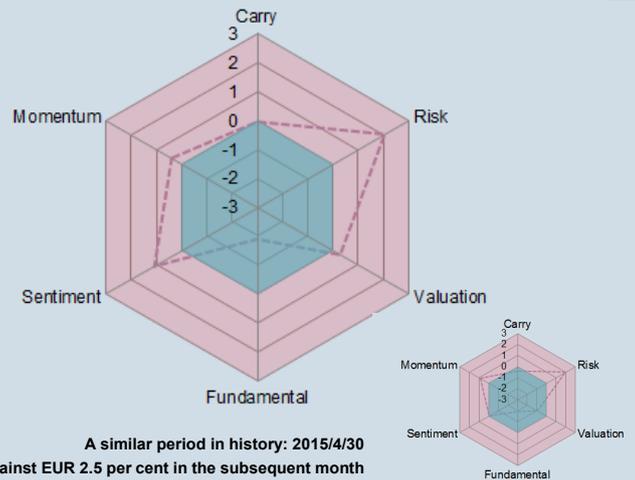
AUD/CNH

- The CNH was trading 5.3 per cent lower against the Australian dollar, or AUD, in March 2016 from a month ago. AUD was bolstered by a report that showed Australia's economy grew at a much faster rate than expected in Q4 2015.
- The historical volatility was below 11 per cent for most of the time in March 2016.
- On the FX radar, the fundamental factor was well below its historical average, while the momentum and sentiment factors were above their historical average.

Fig 14: Offshore/Onshore Spread



Fig 10: FX Radar*



The CNH appreciated against EUR 2.5 per cent in the subsequent month

Fig 12: Historical Volatility vs Implied Volatility

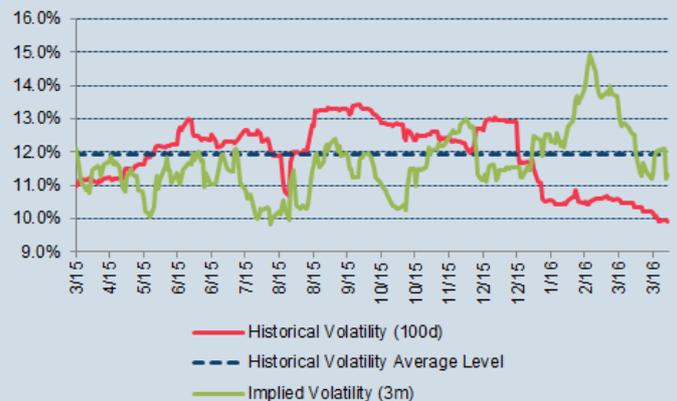
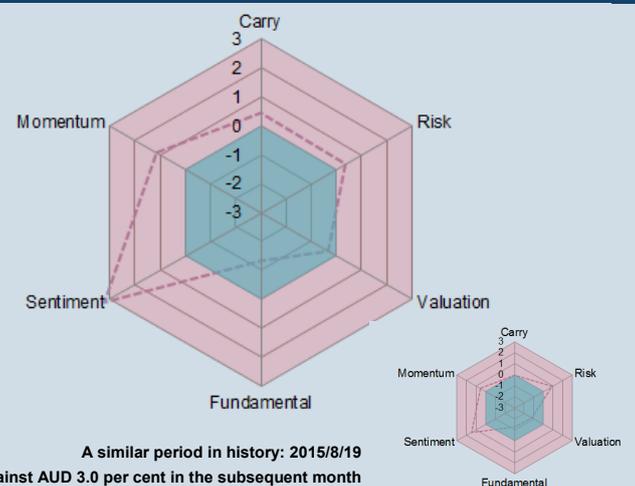
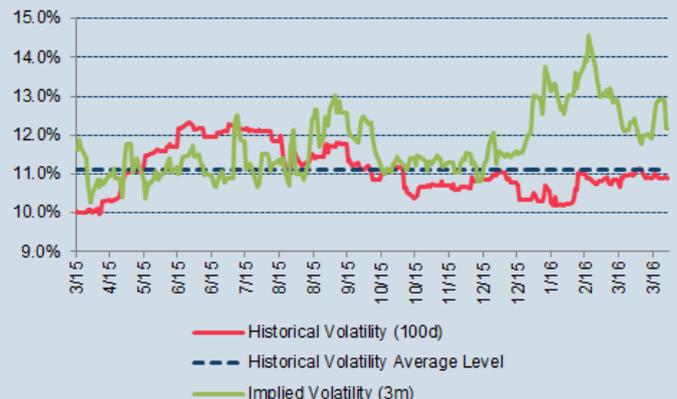


Fig 13: FX Radar



The CNH appreciated against AUD 3.0 per cent in the subsequent month

Fig 15: Historical Volatility vs Implied Volatility



JPY/CNH

- The CNH was trading back and forth between 5.693 and 5.796 against the Japanese yen, or JPY, in March 2016 and ended the month 0.1 per cent higher. JPY's drop against CNH came on the back of comments by Japan's chief cabinet secretary, who said the government would be watching the foreign exchange markets with a "sense of urgency".
- The historical volatility increased to more than 10.5 per cent in March 2016.
- On the FX radar, the sentiment and risk factors were below their historical average, while the momentum and valuation factors were above their historical average.

Fig 16: FX Radar

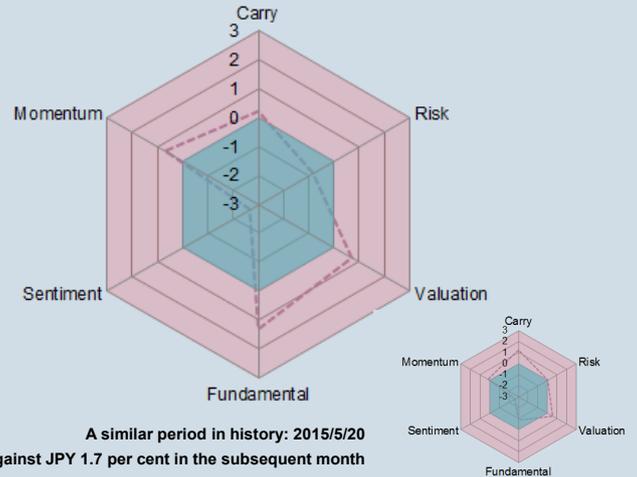
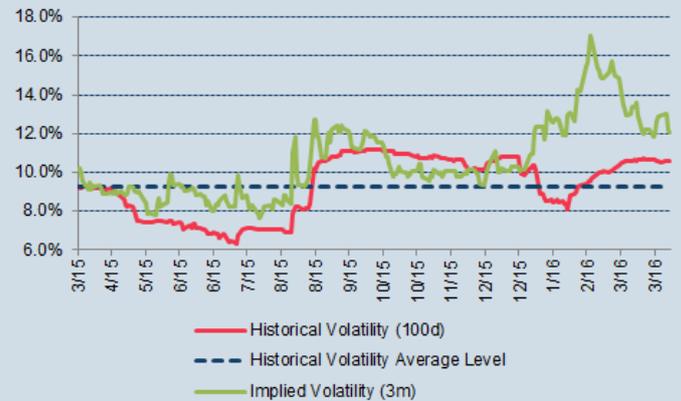


Fig 17: Offshore/Onshore Spread



Fig 18: Historical Volatility vs Implied Volatility



INR/CNH

- The CNH was trading 0.7 per cent lower against the Indian rupee, or INR, in March 2016 from a month ago amid market expectations that the Reserve Bank of India would cut its key lending rates in early April 2016 and that would help growth while supporting INR in the short term.
- The historical volatility decreased to less than 6 per cent in March 2016.
- On the FX radar, the sentiment factor was below its historical average, while the fundamental, valuation and risk factors were above their historical average.

Fig 19: FX Radar

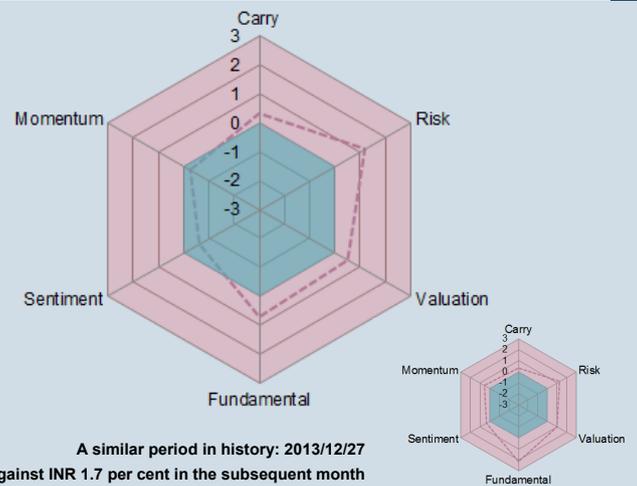


Fig 20: Offshore/Onshore Spread

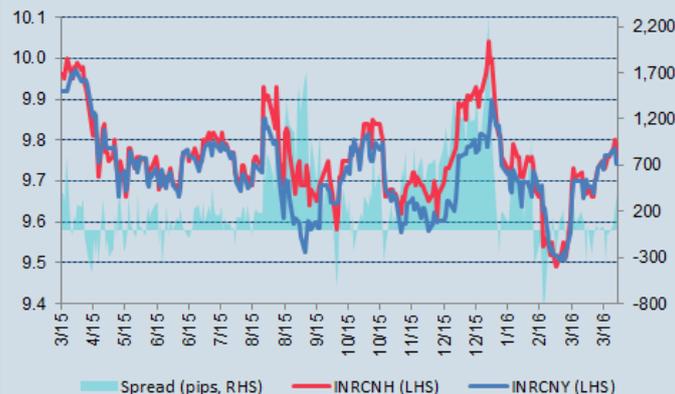
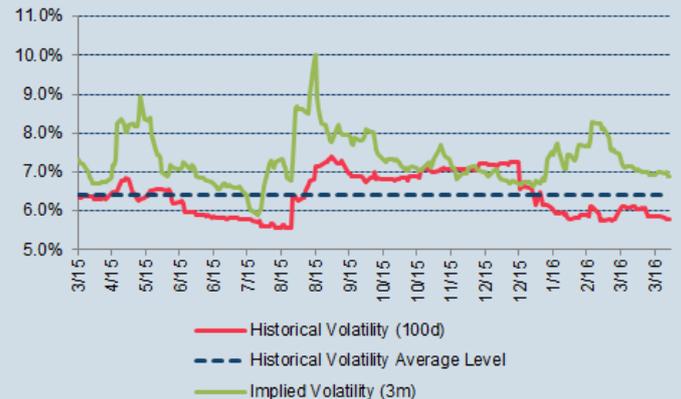


Fig 21: Historical Volatility vs Implied Volatility



MYR/CNH

- The CNH was trading 5.3 per cent lower against the Malaysian ringgit, or MYR, in March 2016 from a month ago as a recent rally in crude prices brightened the growth prospects for Malaysia, which is the region's only major net oil exporter.
- The historical volatility decreased substantially, as it fell to 12 per cent in March 2016.
- On the FX radar, the fundamental and sentiment factors were well below their historical average, while the momentum factor was above its historical average.

Fig 22: FX Radar

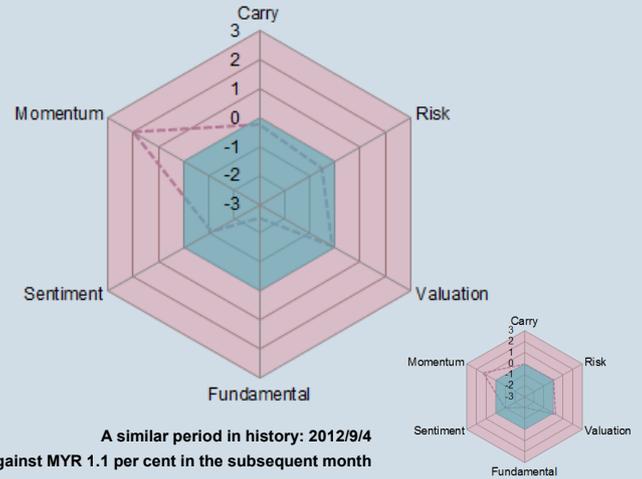


Fig 23: Offshore/Onshore Spread

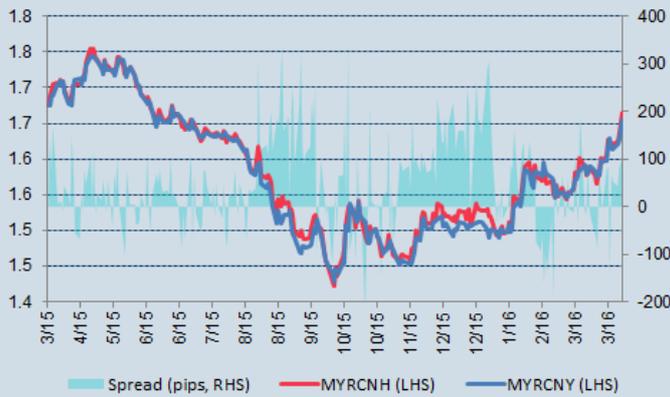
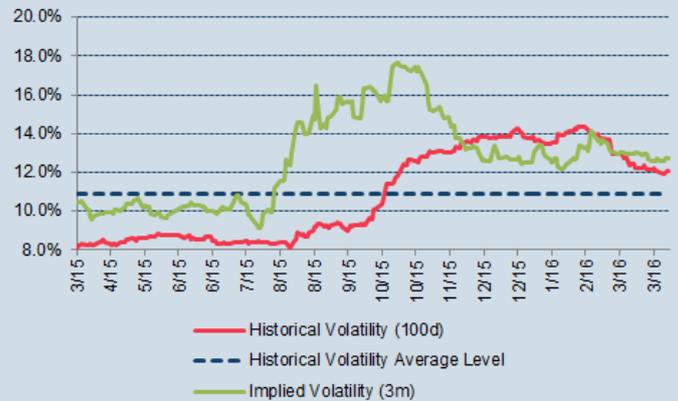


Fig 24: Historical Volatility vs Implied Volatility



CNH/USD

- The historical volatility fell to less than 5 per cent in March 2016.
- On the FX radar, the fundamental factor was well below its historical average, while the momentum factor was above its historical average.
- The CNH-CNY spread remained tight in March 2016. China's commitment to a narrower onshore/offshore spread reduced the basis risk in using the CNH market to hedge CNY exposure.

Fig 25: FX Radar

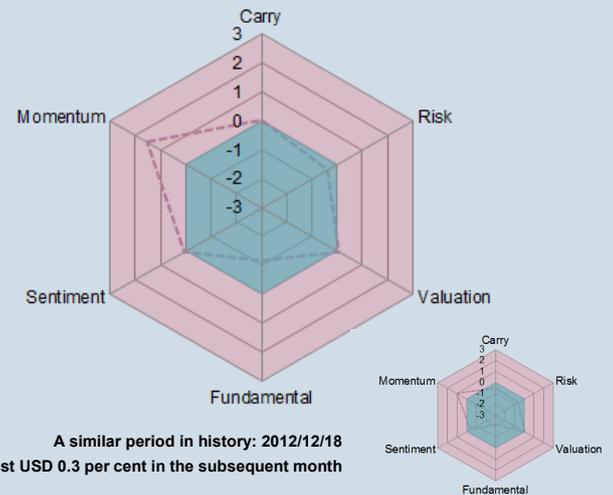


Fig 26: Offshore/Onshore Spread

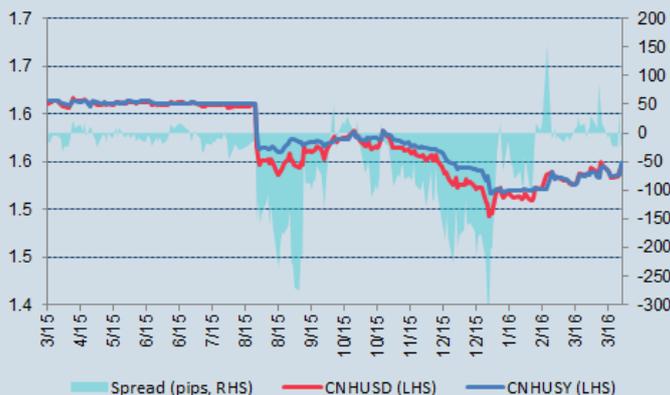
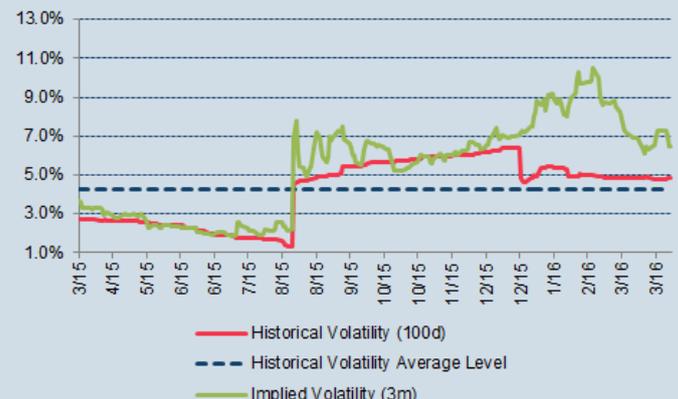


Fig 27: Historical Volatility vs Implied Volatility



OFFSHORE BOND MARKET DYNAMICS

OFFSHORE RMB BOND MARKET COMMENTS

- There were no primary issues in CNH in March 2016. RMB deposits in Hong Kong at the end of February 2016 were down by more than 17 per cent from a year ago. With less money offshore, demand for offshore RMB debt has dwindled.
- RMB deposits in Hong Kong decreased by 5.65 per cent month-on-month to RMB803.4 billion at the end of February 2016. The total remittances of RMB for cross-border trade settlement amounted to RMB279.8 billion in February 2016, compared to RMB480.1 billion in January 2016.

Fig 28: Offshore RMB Deposits vs Outstanding Dim Sum Bonds

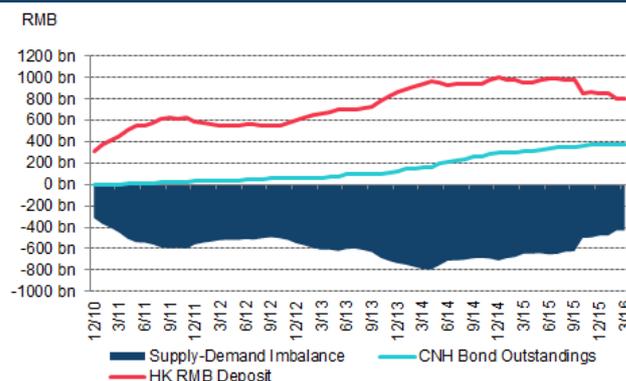


Fig 29: RMB Bond Issuances by Issuer Type

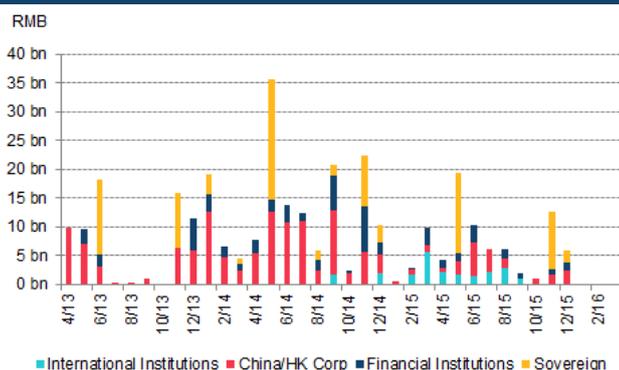
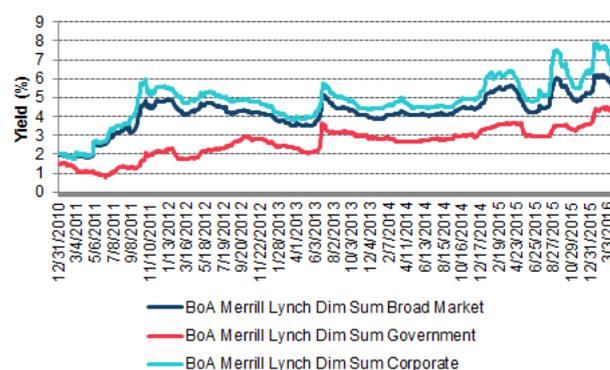


Fig 30: Dim Sum Bond Performance



ONSHORE BOND MARKET DYNAMICS

ONSHORE RMB BOND MARKET COMMENTS

- Onshore bond issuance increased 45 per cent to RMB4 trillion in March 2016 from RMB2.8 trillion in February 2016. Local government bonds accounted for more than 50 per cent of the total increase in new issuance.
- The onshore/offshore five-year Ministry of Finance (MoF) Treasury Bond (T-Bond) yield spread continued to widen. Between the beginning of the year and March 2016, the spread expanded more than 1 per cent, as the five-year MoF T-Bonds was trading at 2.68 per cent onshore versus 3.70 per cent offshore around the end of March 2016.

Fig 31: MoF T-Bond Yield 5Y: Onshore vs Offshore (%)

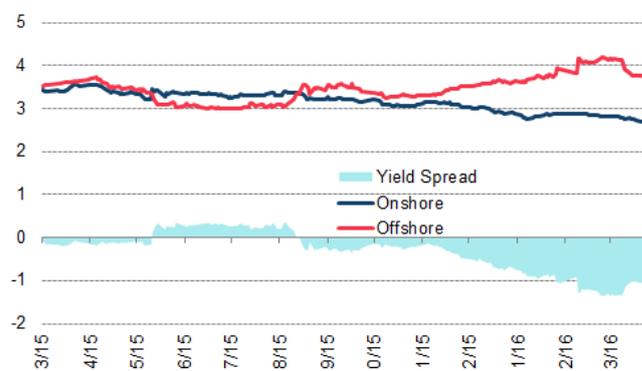


TABLE 2

Key Figures on Interbank Market Cash Bond Transactions (classified as per bond types)			
Bond Type	Number of Deals	Trading Value(100M)	Yield to Maturity(%)
Policy Financial Bond	44,183	48,843.45	2.9557
Treasury Bond	7,626	10,034.18	2.5339
Medium-term Note	15,085	12,163.35	4.5942
Corporate Bond	11,685	7,554.34	4.4995
CDs	5,221	12,021.72	2.9535
Commercial Paper	20,458	17,531.76	3.3738
Central Bank Paper	51	86.86	2.3119
Others	4,633	5,173.67	4.7293
Total	108,942	113,409.33	3.3351

Fig 32: MoF T-Bond Outstanding Split by Tenor

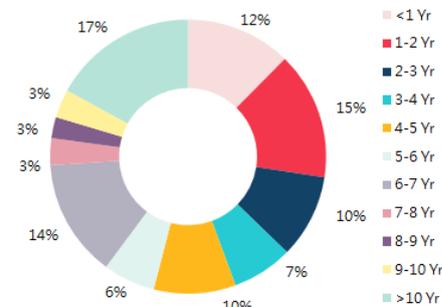


TABLE 3

NAFMII Guidance for Non FI Debt Issuing (as of 2016/3/31)																
	1Yr	MoM	3Yr	MoM	5Yr	MoM	7Yr	MoM	10Yr	MoM	15Yr	MoM	20Yr	MoM	30Yr	MoM
AAA+	3.05	↓	3.58	↓	3.81	↓	4.17	↓	4.44	↑	5.02	↑	5.19	↓	5.46	↓
AAA	3.24	↓	3.74	↓	3.98	↓	4.49	↓	4.74	↑	5.35	↑	5.60	↓	5.90	↓
AA+	3.44	↓	4.08	↓	4.45	↓	4.97	↓	5.38	↓	5.97	↑	6.34	↑	6.64	↑
AA	3.95	↓	4.59	↓	5.01	↓	5.61	↓	5.95	↓	6.65	↑	7.00	↑	7.45	↓
AA-	5.32	↓	5.91	↓	6.41	↓	7.35	↓	7.81	↓	8.33	↓	8.70	↓	9.00	↑



ONSHORE/OFFSHORE SHORT-TERM INTEREST RATE DYNAMICS

ONSHORE/OFFSHORE RMB STIR MARKET COMMENTS

- Hong Kong's overnight Treasury Market Association CNH HIBOR decreased from 2 per cent to 1 per cent in March 2016, as offshore RMB liquidity remained relatively loose due to the required reserves ratio rule the PBOC imposed on RMB deposits in the onshore market.
- The CNH HIBOR yield curve looked flatter at the end of March 2016 than it did at the end of March 2015 (see Figure 35).

Fig 33: CNH Implied Yield vs. USD/CNH

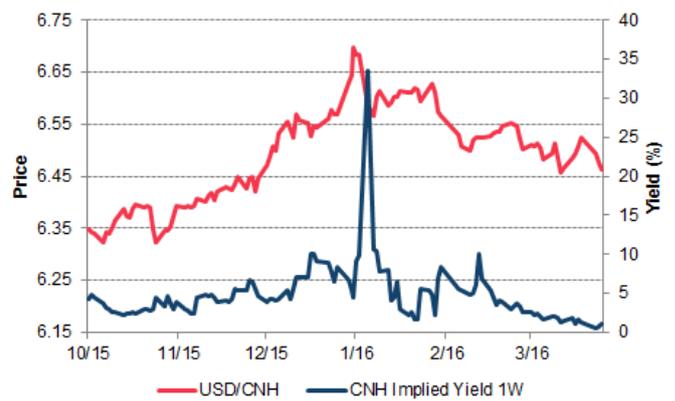


Fig 34: CNY SHIBOR Yield Curves

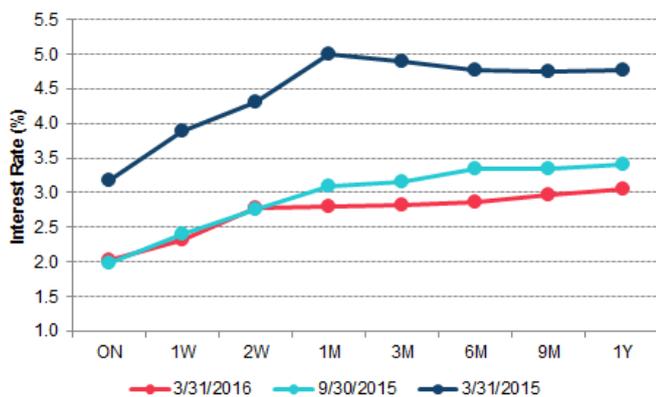


Fig 35: CNH HIBOR Yield Curves

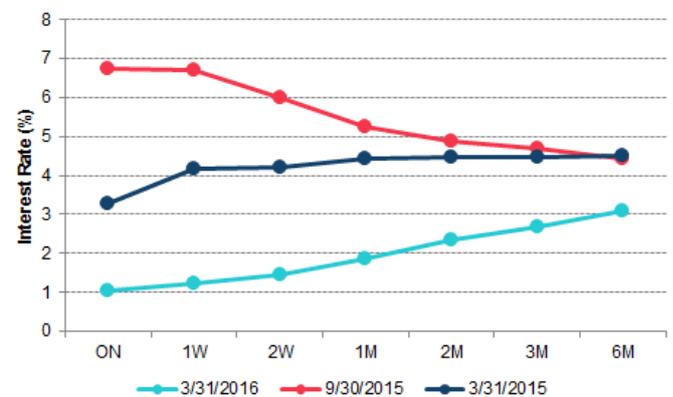


Fig 36: Onshore IRS (7D Repo) Yield Curves

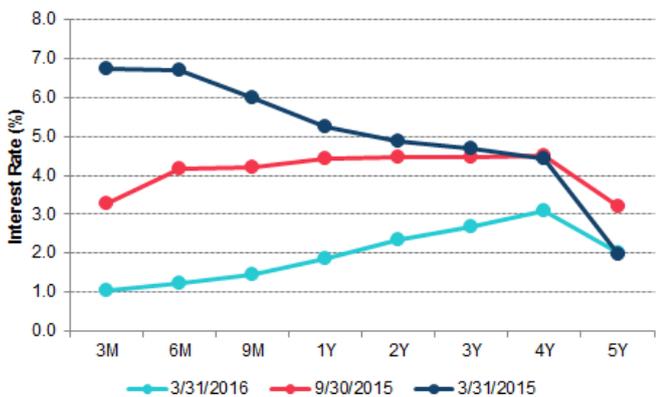


Fig 37: Onshore IRS Trading Notional Principal

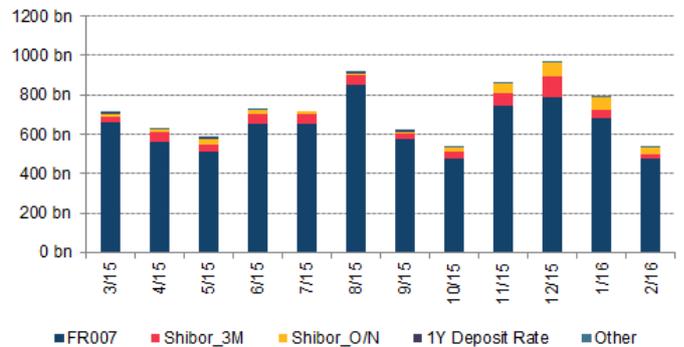


Fig 38: CNY SHIBOR vs CNH HIBOR

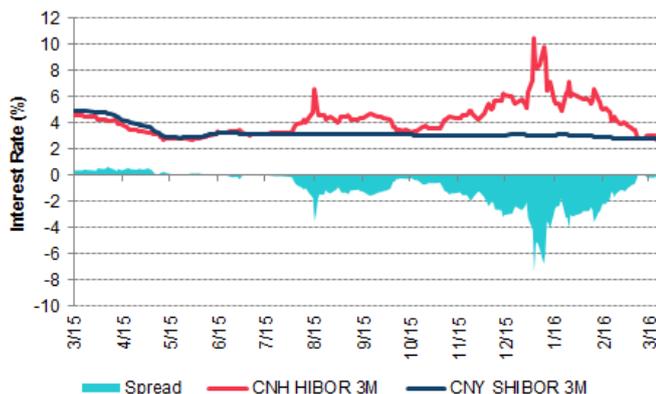
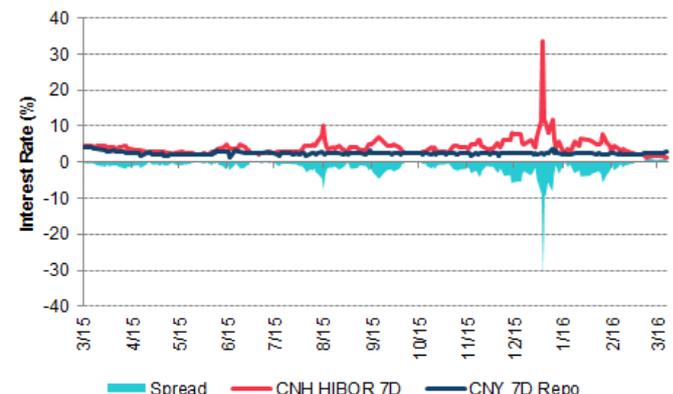


Fig 39: CNY 7D Repo vs CNH HIBOR



(Continued from page 1)

Based on current data, the most outstanding performer among first-tier cities is Shenzhen, followed by Shanghai. In January 2016, property prices in Beijing, Shanghai, Guangzhou and Shenzhen rose by 1.1 per cent, 2.6 per cent, 0.8 per cent and 4.1 per cent respectively. Since 2015, the property prices in Shenzhen have been leading Mainland property prices. Firstly, the supply in Shenzhen is inadequate, and the demand/supply relationship remains tense. Secondly, the inventory is low, with only slightly more than 30,000 flats for sale, and a turnover cycle of less than six months. Thirdly, domestic demand is strong. Unlike other first-tier cities, Shenzhen is a city of migrants, and most permanent residents have only one or no flat of their own, so demand is huge, especially when prices are inflating and some want more than one flat for investment purposes. According to statistics, the percentage of investment demand in Shenzhen is more than 20 per cent of total demand, higher than in other Mainland cities (Beijing's is around 10 per cent). Finally, the investment need of capital outside Shenzhen is also an important factor.

2. Property new deal indirectly stimulates real estate sector in first-tier cities

Although the down payment reduction and tax incentive policy announced in February 2016 does not apply to first-tier cities, the relaxed policy has an indirect stimulating effect on properties in those cities, as manifested in the pick-up of property transactions, and property owners' optimism about property prices.

Property transactions pick up

In the eighth week of 2016, property agent Beijing Lianjia reported a significant rise of 40 per cent in the average daily number of new clients from before the Lunar New Year festival. The supply to demand ratio was 1:5.2, compared to 1:4.7 before the festival. The gap between supply and demand widened, too. On 19 February 2016, three government ministries jointly revised deed tax and business tax to address demand for upgrades to large apartments in non-first-tier cities. Although individual income tax was not involved, and the deed tax and business tax adjustment was limited, the tax incentives did stimulate the existing real estate sector to a certain extent, and it signalled to the market that policies have been eased. While the incentives may have little impact on first-tier cities, they are still expected to present some stimulus there, and trading has evidently picked up.

In February 2016, among the flat sellers who adjusted their asking prices at Lianjia, 73 per cent raised them. Prices were 12 per cent higher than in January 2016. It was the fifth straight month prices surged. February's average price adjustment was +2.8 per cent, up from 1.7 per cent in January 2016. Since December 2015, price adjustments have moved from negative to positive territory and the changes are widening. To a certain extent, it shows that since the end of 2015, owners have become increasingly optimistic about property prices.

Owners' price expectation rises while room for price negotiation narrows

In February 2016, there was a 1.7 per cent range for price negotiation in property deals conducted through an intermediary in Beijing, down from 2.0 per cent the previous month. It was the lowest figure seen since 2012. In February, the average price asked for a flat newly listed at an agent was RMB41,407 per square metre, up 0.5 per cent from the previous month. As the price expectation of flat owners rises, property prices are more likely to rise further.

3. Latest demand for properties features new characteristics

The latest round of market recovery features characteristics that are quite unlike those in previous cycles

Demand will come mainly from an increasing need for better properties

- I. **Genuine resident demand.** The area of residential flats sold in China in 2000-2015 totalled 1,070,000 square meters, representing about 44 per cent of existing urban residential flat space in Mainland cities and towns. That means more than 50 per cent of flats were old. Residents in these old flats also have a pressing need to improve their living conditions. According to statistics from recent research on the Beijing real estate sector*, of the latest transactions, as much as 74 per cent of them were aimed at improving living conditions, up from 64 per cent at the beginning of the year.
- II. **Policy support.** Mainland authorities started to relax policies for the real estate sector in the second half of 2014. To support inelastic demand and the upgrade demand, favourable measures were rolled out one after another, including easy credit, new measures announced at the end of March and September 2015, business tax incentives aimed at stimulating trading in the existing inventory, and down payment reduction and tax incentives in February 2016. At present, the down payment ratio for a second flat is 30 per cent, the lowest since the 2010 purchase restrictions. According to Lianjia data, average interest on a housing loan for a second flat is at a 13-year low of 6.3 per cent. Property buyers are under substantially less pressure to settle their debt. The relaxation of the one-child policy could also bring new demand for better flats.
- III. **Improved new supplies in the high-end market drive upgrade demands.** As the land premium for new flats continues to rise, property prices per floor area in 2015 for large, medium and small flats were up 317 per cent, 268 per cent and 145 per cent respectively, compared to prices in 2008. Some land auctioned in Beijing on 24 June 2016 was sold for almost RMB50,000 per square metre at a premium rate as high as 50 per cent. The selling prices of flats built on the land could reach RMB100,000 per square metre. Therefore, it can be expected that improvement of living conditions will become increasingly dominant in transactions in new properties. Take Beijing as an example. In January to February 2016, transactions in large-size properties (those with three rooms or more) were 65.7 per cent of total transactions, up 8.6 per cent from 2015 and 30 per cent from 2009. Given the relaxation



of the one-child policy, demand for better flats with three rooms or more is expected to increase further.

Real estate policies drive investment demand in first-tier cities

Real estate has the dual function of investment and consumption. Investors' expectation of a rise in property prices will trigger a rise in investment demand. In the past year, properties in first-tier cities demonstrated a high capability to preserve capital and add value. According to data announced by the National Bureau of Statistics in January 2016, first-tier cities Beijing, Shanghai, Guangzhou and Shenzhen saw their property prices rise by an accumulated 11.6 per cent, 21.6 per cent, 10.2 per cent and 51.5 per cent respectively between March and December 2015. In January 2016, the prices of new and second-hand properties rose 4.1 per cent and 5.7 per cent respectively. Second-hand properties saw an even larger price surge, exceeding the level seen in 2013. In the past, property booms usually invited tightening measures. In the current environment of policy relaxation, the recent surge in property prices has not led to government suppression thereby giving a boost to property investment in first-tier cities.

4. Latest demand for properties features new characteristics

Possible policy tightening in first-tier cities in an environment of generally relaxed policies

As unsold property units are abundant, government policy leans towards relaxation. If recent measures such as down payment reduction and deed tax and business tax incentives are not too effective, the market believes other property incentives will be rolled out. For instance, the individual income tax has not yet been adjusted, and there is room for adjustment in personal home mortgage interest tax, business tax and deed tax (e.g. taxing properties sold after less than one year of ownership rather than two years). However, due to industry and resources problems at third- and fourth-tier cities, as well as the trend for the population to move towards centrally located cities, it is difficult for all unsold properties to be sold in a short time. It may take at least one or two years or even longer. The current relaxed policy for the Mainland's real estate sector is expected to be around for quite a long time.

The rise in property prices in first-tier cities has been excessive, especially since the Lunar New Year holiday. Tightening measures are mostly likely to be launched in Shenzhen and Shanghai, where property prices leapt especially high. Beijing and other first-tier cities with property prices on a rising trend will be the second batch to be affected.

Third-tier cities have fared well so far in 2016, but performances varied notably

Recent market data shows some third-tier cities performed quite well. Yangzhou, for example, saw a small jump in the number of property transactions in January. This may be due to a low base from the previous period and the concentration of home buying before the Lunar New Year holiday, when people returned to their home towns. It is expected the real estate sector in some second- and third-tier cities will continue to pick up as state authorities introduce various measures to clear unsold property units.

Generally speaking, the real estate sector in first-tier cities is still the most active with demand outstripping supply. Unsold properties continue to decrease and the turnover cycle continues to shorten leading to the recent surge in property prices in first-tier cities. In contrast, in the majority of second- and third-tier cities, the sale of unsold properties is more difficult as supply outstrips demand, unsold units keep increasing and the turnover cycle lengthens.

The real estate sector's contribution to GDP has peaked. It is now a source of downward pressure on the Mainland investment market

During rapid urbanisation, Mainland economic growth is driven by investment, and the real estate sector plays an important role. In the past 10 years or so, investment has been dominant among the three drivers of Mainland economic growth. Property investment takes up almost 20 per cent of total investment in the Mainland. The real estate sector's contribution to the Mainland economy is about 8 per cent. Properties boost Mainland GDP growth by an average of 0.5 to 1.5 percentage points annually.

However, in the past two years, economic growth has been dragged down by continuing slides in property investment. In the fourth quarter of 2015, the real estate sector only boosted GDP growth by a fifth of a point, which is on the low side. In 2015, Mainland property investment growth slid to 0.4 per cent, down nearly nine basis points from 2014. On the one hand, it reveals property developers' pessimism about the future, their apathy in making new investments and the peaking of property prices. On the other hand, the fall in investment limits had a stimulating effect on investment on the general economy.

Each industry has its own development cycle. Real estate is no exception. After more than 10 years of rapid development, as the structure of the Mainland population and macroeconomic growth changes, Mainland property prices have generally peaked. The Mainland real estate sector is now in the second half of a cycle. The stimulus it can offer to total investment is diminishing. Its downturn will also exert downward pressure on the Mainland economy. That explains why real estate sector developments have been a general policy concern.

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EXPERT CORNER

THE GROWING EURO BOND ISSUANCE FROM CHINA

Contributed by Dr. Wei Wang (Steve), Head of Fixed Income Research at Bank of China International

Reflecting a global trend of growing corporate interests in raising funds in euros, an increasing number of Chinese companies have also turned to the euro bond market for funds since 2014. Although relatively small in volume as compared to the region's much developed USD bond market, Asia issuers have been tapping the euro bond market for many years. Over the past 15 years, a total of about €57bn of euro bond issuance has been reported, according to our estimate, in contrast to the total amount of \$160bn in USD issuance from Asia ex-Japan issuers in 2015 alone. Traditionally, the region's big financial firms and multi-national corporations were the most active Asian issuers in the euro bond market.

Euro bond issuance by Asian issuers has picked up significantly starting from 2013. Similar to the motivation of their global peers, they aimed to take the advantage of euro's much lower borrowing costs. The total euro bond issuance from Asia ex-Japan reached €13bn in 2015, more than triple of the early record reached in 2005.

Many Chinese issuers have also joined the party and become the main driver for the market growth. In 2014, there were 3 Chinese issuers tapping the euro bond market for a total of €2.2bn, and in 2015, the number jumped to 18 for a total of €10.4bn. In fact, we have seen an increasing number of Chinese non-financial firms entering the euro bond market.

For Chinese issuers, the tapping of the euro bond market is driven by both finance and business considerations. The low absolute coupon rates achievable in the euro bond market, averaging at 1.4 per cent among the Chinese investment-grade issues in 2015, have been the main attraction. In addition, the market expectation of further euro weakness over the medium term also makes borrowing in euro appealing. An issuer without direct business needs for euro funds would still look for raising funds in euro in order to lock up low finance costs.

On the other hand, many Chinese companies indeed have real funding needs in euro for their active business or project development in the Euroland. Europe has recently become a top destination for Chinese outbound foreign direct investment (ODI). According to Deloitte, Chinese companies spent over \$35.5bn in European M&As in 2015, making up 54 per cent of their total global M&A spending (data up to November 16, 2015). The figure also represents a nearly 13x growth over their \$2.7bn M&A spending in Europe in 2009. The trend is expected to continue, given the more friendly policy environment in Europe for Chinese M&As and under the grand Chinese global development initiative of "One Belt One Road".

European investors have so far responded favorably to the Chinese euro bonds. On one hand, the extremely low yields offered by European issuers have made the Chinese issues with higher spread premium more attractive. On the other hand, European investors have become better equipped with understanding and knowledge on China and on Chinese companies in recent years and thus found more comforts to invest in Chinese bonds. For some of the recent new issues, as high as 70 per cent of the bonds were allocated to European investors. Nevertheless, Asian participation in Chinese euro bonds is still limited, as compared to the situation that Chinese USD bond issuers can easily sell 80-90 per cent of allocation to Asia-based accounts.

In summary, Chinese euro-denominated bonds are emerging as a seemingly new bond class for global credit investors. With more companies looking for debut issuance in this market, either from finance or from business considerations, this Chinese bond segment is expected to expand further, offering global investors more choice of fixed income return and asset diversity. However, as past issuance experience has shown, a sustained demand from European investors is critical for the segment's continued growth, at least for the foreseeable future.



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APPENDIX: DEFINING THE FX RADAR

We selected a number of factors that drive RMB currency pairs, including carry (yield spread), risk (volatility), valuation (terms of trade), fundamentals (trade balance), sentiment (risk reversal), and momentum (three-month return). Factor values were normalized based on the most recent one-year data and plotted on our FX radar graph. For example, a factor value of 1 for “carry” indicates that the current yield spread is one standard deviation above its mean over the past year.

The red dotted line represents the prevailing factor dynamics of the specific RMB FX pair. Against the current factor dynamics, we identified the most similar patterns in past history by means of optimization across the six driving factors. The historical price movement of that particular period is shown for reference.

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