



China Monthly: Rising challenges will trigger more policy easing in 2016

- **Economic outlook:** China's economy had a tough year in 2015. 2016 will likely be even more challenging. The current round of policy easing may help to boost growth in Q4 2015 and Q1 2016, but also exacerbate overcapacity and raise leverage, both damaging in the longer term. In mid 2016 the government may face a policy dilemma again. Downward pressure on growth will probably resurface, and force the government into further policy easing.
- **Main risks:** More policy easing, while helpful to maintain growth, would exacerbate structural problems such as overcapacity and high leverage, making future adjustments even more challenging.
- **Strategy:** We maintain our long bias on RMB bonds/rates market in 2016 as we believe the overall demand and supply balances remain favorable. We forecast 10Y CGB yield to trade between 2.7-3.2%, 10Y CDBs between 3.1%-3.6% in 2016 and 5Y NDIRS to range between 2.2-2.8%. Our curve risk is neutral to slight steepening considering liquidity and growth risks. We recommend trade the cash and rates market in these ranges with a long bias. We expect cash bond market demand to be supported mainly by commercial banks/policy banks, fund houses and insurance companies. On onshore credit, we expect IG sector to outperform and recommend add allocation of liquid IG names. In the offshore RMB market, we expect the offshore onshore basis in the money market rates to persist before positioning in the FX market becomes more balanced and we forecast net issuance of RMB50-100bn in the offshore RMB bond market in 2016.