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2015 Central Economic Work Conference: more reforms to come

The Central Economic Working Conference held in Dec 2015 centers on the main themes of mitigating the impacts of economic rebalancing, fostering economic recovery through reducing industrial overcapacity, slashing destocking unsold homes, lowering costs for businesses, reducing leverage, and lessening financial risks. Greater emphasis will be placed on a series of supply-side reforms, along with expansionary fiscal policy and moderately loose credit policies to generate new demand and higher productivity. Although the GDP target for 2016 has not been disclosed during the conference, we believe China would maintain economic growth in a reasonable pace. With sustainability as its priority, the country will experience a structural slowdown and we expect GDP growth will moderate to 6.8% for 2016.

Proactive fiscal measures to boost economic momentum. The government seeks to raise the budget deficit amid China's decelerating economy. The national fiscal deficits for 2014 and 2015, as a percentage of GDP, were 1.8% and 2.3% (target) in China, as compared to the 10% in the U.S. and 6% in the Eurozone. Hence, we believe deficit raising is possible in 2016. To counteract the shrinking domestic demand, we expect more aggressive stimulus packages to be rolled out to fuel consumption and industrial growth. These measures include: (1) acceleration in approval for infrastructure and construction projects; (2) additional subsidies for energy-efficient consumer products; (3) encouraging private capital to flow into large industrial sectors conventionally dominated by state firms with high entry barriers; (4) tax reform to support the services sector. These growth-promoting measures will work in tandem with the extended structural reforms promoting domestic consumption and sustainability.

More measures to revitalize the real estate market. In 2016, consolidation of the real estate market would lead to a new round of M&A activities and exit of smaller players. In addition, we see opportunities in developing the property rental market, which would help absorb existing inventory in the short term and initiate changes in the business model of the current property market. However, the immediate impacts on the real estate market would come from the government's direct intervention in expanding the availability of low-rent public housing to city dwellers and reforming the household registration system to increase the pool of potential homebuyers.

Reducing industrial overcapacity remains a challenge. Technological innovations have led to consolidation of external and domestic demand, while declining commodity market has also resulted in a distressed sentiment in the industrial sector. Lower growth momentum in China has brought about changes in the commercial focus of business owners in China. Under such pressure, industrial overcapacity presents a thorny issue to China. We believe a new wave of bankruptcies and M&As will ensue in the industrial sector starting from 2016. New policies and legislations are likely implemented to facilitate asset liquidation, corporate restructuring, and settlement of unemployed workers. From a more positive perspective, the government could take this opportunity to encourage the industrial sector to phase out outdated technologies to upgrade the manufacturing industry and develop the high-tech industry in China.

Systematic deleveraging to ensure long-term financial stability. The emphasis on deleveraging to reduce systematic risk mainly focuses on the issues of local government debt and credit default. While the government would allow for a default in corporate bonds so as to promote other economic objectives, a default in local government bond is highly unlikely. Since the economic restructuring would continue to exert pressure on the balance sheets of local governments, we expect more financial engineering products, such as asset securitization, would be used to smoothen the transition by providing local governments with more financial backing.

Private sector to be helped by the government. To support the private sector amid the economic downturn, the central government would employ more policy tools. Aside from the traditional accommodative monetary policies, we expect more aggressive tax reforms to alleviate financial burden of corporates. In addition, the government's stance on promoting entrepreneurship and innovation would continue to further enhance the development of the tertiary industry, which in turn would stimulate employment and upgrade of the Chinese economy.

China Economic Indicators

	2014					2015										
	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Real GDP (YoY%)	---	7.3	---	---	7.3	---	---	7.0	---	---	7.0	---	---	6.9	---	---
Export Growth (YoY%)	9.4	15.3	11.6	4.7	9.7	(3.2)	48.3	(15.0)	(6.4)	(2.5)	2.8	(8.3)	(5.5)	(3.7)	(6.9)	(6.8)
Import Growth (YoY%)	(2.4)	7.0	4.6	(6.7)	(2.4)	(19.7)	(20.5)	(12.7)	(16.2)	(17.6)	(6.1)	(8.1)	(13.8)	(20.4)	(18.8)	(8.7)
Trade Balance (USD/bn)	49.8	30.9	45.4	54.5	49.6	60.0	60.6	3.1	34.1	59.49	46.6	43.0	60.2	60.3	61.6	54.1
Retail Sales Growth (YoY%)	11.9	11.6	11.5	11.7	11.9	10.7		10.2	10.0	10.1	10.6	10.5	10.8	10.9	11.0	11.2
Industrial Production (YoY%)	6.9	8.0	7.7	7.2	7.9	6.8		5.6	5.9	6.1	6.8	6.0	6.1	5.7	5.6	6.2
PMI - Manufacturing (%)	51.1	51.1	50.8	50.3	50.1	49.8	49.9	50.1	50.1	50.2	50.2	50.0	49.7	49.8	49.8	49.6
PMI - Non-manufacturing (%)	54.4	54.0	53.8	53.9	54.1	53.7	53.9	53.7	53.4	53.2	53.8	53.9	53.4	53.4	53.1	53.6
FAI(YTD) (YoY%)	16.5	16.1	15.9	15.8	15.7	13.9		13.5	12.0	11.4	11.4	11.2	10.9	10.3	10.2	10.2
CPI (YoY%)	2.0	1.6	1.6	1.4	1.5	0.8	1.4	1.4	1.5	1.2	1.4	1.6	2.0	1.6	1.3	1.5
PPI (YoY%)	(1.2)	(1.8)	(2.2)	(2.7)	(3.3)	(4.3)	(4.8)	(4.6)	(4.6)	(4.6)	(4.8)	(5.4)	(5.9)	(5.9)	(5.9)	(5.9)
M2(YoY%)	12.8	12.9	12.6	12.3	12.2	10.8	12.5	11.6	10.1	10.8	11.8	13.3	13.3	13.1	13.5	13.7
New Lending (RMB/bn)	702.5	857.2	548.3	852.7	697.3	1,470	1,020	1,180	707.9	900.8	1,280.6	1,480	809.6	1,050	513.6	708.9
Aggregate Financing (RMB bn)	957.7	1,135.5	662.7	1,146.3	1,690	2,047	1,356	1,241	1,056	1,236	1,833	742	1,082	1,300	476.7	1,020

World Economic/Financial Indicators

Equity Indices

	Closing price	Chg. WTD (%)	P/E
U.S.			
DJIA	17,251.62	0.72	15.41
S&P 500	2,021.15	0.78	18.05
NASDAQ	4,968.92	0.93	31.16
MSCI US	1,927.27	0.75	18.70
Europe			
FTSE 100	6,078.80	0.44	27.20
DAX	10,617.31	0.09	22.68
CAC40	4,604.79	(0.44)	21.11
IBEX 35	9,451.20	(2.74)	18.05
FTSE MIB	21,274.70	0.15	1,595
Stoxx 600	359.94	(0.36)	23.03
MSCI UK	1,758.19	(0.30)	27.74
MSCI France	129.08	(1.25)	21.13
MSCI Germany	137.49	(1.08)	21.98
MSCI Italy	60.27	(0.66)	N/A
Asia			
NIKKEI 225	18,886.70	(0.53)	19.68
S&P/ASX 200	5,116.69	0.20	18.42
HSI	21,830.02	0.34	9.60
HSCEI	9,731.53	1.01	7.21
CSI300	3,876.73	2.89	16.37
SSE Composite	3,651.77	2.03	19.20
SZSE Composite	2,379.63	1.88	55.55
MSCI China	59.49	0.54	10.46
MSCI Hong Kong	11,960.36	0.03	9.98
MSCI Japan	929.77	(0.35)	15.92

* As of 12:00 AM closing

Global Commodities

	Unit	Price	Chg. WTD (%)	Volume (5-day avg.)
Energy				
NYMEX WTI	USD/bbl	36.06	3.83	243,335
ICE Brent Oil	USD/bbl	36.57	(0.84)	137,187
NYMEX Natural Gas	USD/MMBtu	1.93	9.22	175,314
Australia Newcastle Steam Coal Spot fob[2]	USD/Metric Tonne	61.80	N/A	N/A
BasicMetals				
LME Aluminum Cash	USD/MT	1,520.75	0.95	21,794
LME Aluminum 3 -mth. Rolling Fwd.	USD/MT	1,513.00	0.50	33,182
CMX Copper Active	USD/lb.	4,741.00	1.09	8,525
LME Copper 3- mth Rolling Fwd.	USD/MT	4,738.00	1.13	48,469
Precious Metals				
CMX Gold	USD/T. oz	1,077.60	1.18	134,313
CMX Silver	USD/T. oz	14.23	0.95	45,012
NYMEX Platinum	USD/T. oz	877.60	1.95	17,801
Agricultural Products				
CBOT Corn	USD/bu	372.00	(0.67)	168,417
CBOT Wheat	USD/bu	479.75	(1.44)	59,786
NYB-ICE Sugar	USD/lb.	14.97	(0.86)	52,963
CBOT Soybeans	USD/bu.	892.00	(0.08)	106,408

Bond Yields & Key Rates

	Yield (%)	Chg. WTD (Bps)
US Fed Fund Rate	0.50	0.00
US Prime Rate	3.50	0.00
US Discount Window	1.00	0.00
US Treasury (1 Yr)	0.1220	(2.54)
US Treasury (5Yr)	1.6663	(0.99)
US Treasury (10 Yr)	2.1916	(1.24)
Japan 10-Yr Gov. Bond	0.2750	0.50
China 10-Yr Gov. Bond	2.9400	(11.0)
ECB Rate (Refinancing)	0.05	0.00
1-Month LIBOR	0.4130	8.25
3 Month LIBOR	0.5855	7.35
O/N SHIBOR	1.8750	5.90
1-mth SHIBOR	2.9440	12.20
3-mth HIBOR	0.3915	0.01
Corporate Bonds (Moody's)		
Aaa	3.91	0.00
Baa	5.44	7.00

Note:
1. Data sources: Bloomberg, National Bureau of Statistics of China, ABCIS (updated on date of report)
2. Australia Newcastle Steam Coal Spot fob is the Australia Newcastle 6700 kc GAD fob Steam Coal Spot price published by McCloskey

Currency

	Euro/USD	GBP/USD	AUD/USD	USD/JPY	USD/CHF	USD/CNY	USD/HKD	USD/CNY NDF 12-mth Spot pr.
Spot Rate	1.0915	1.4897	0.7242	121.07	0.9931	6.4785	7.7530	6.7697
Chg. WTD (%)	0.43	0.01	0.92	0.07	(0.09)	0.04	(0.00)	0.14

Disclosures

Analyst Certification

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Definition of equity rating

Rating	Definition
Buy	Stock return ≥ Market return rate
Hold	Market return – 6% ≤ Stock return < Market return rate
Sell	Stock return < Market return – 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months
Market return: 5-year average market return rate from 2009-2013
Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	2.6 ≤180 day volatility/180 day benchmark index volatility
High	1.5 ≤ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	1.0 ≤180 day volatility/180 day benchmark index volatility < 1.5
Low	180 day volatility/180 day benchmark index volatility < 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.
Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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