



Economics Weekly March 1, 2016

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First RRR cut in 2016

The People's Bank of China (PBOC) announced to lower the reserve requirement ratio (RRR) by 50 bps for all financial institutions, effective March 1, 2016. This is the first system-wide RRR cut since October 2015. China's large banks will see their ratio reduced from 17.5% to 17.0%. Overall, the cut will free up RMB 700 billion in potential credit. This RRR cut, conducted prior to the opening of China's National People Congress (NPC) and the release of dismal PMI data for February, reveals stagnation in China's economic momentum and additional monetary easing will become increasingly necessary.

Monetary easing before the opening of NPC. China's National People Congress (NPC) will convene in early March. Given the current economic slowdown, the NPC's focus this year will be on fostering domestic demand through stimulus measures. The latest RRR cut announced prior to the opening of NPC denotes the government's intention to expand liquidity in the economy.

Timing is in line with our expectation. Our forecast in December for an RRR cut (for details please refer to our previous report, 2015 Economic Outlook and Investment Strategy: Prosperity in the Making, dated December 11, 2015) was based on our understanding that PBOC tends to signal policy easing and encourage loan growth in a gradual manner. With inflation softening further in recent months and liquidity decreasing after the Spring Festival, an RRR cut is much needed to sustain economic growth.

Around RMB 700 billion will be injected into the economy. The government's current focus is on stimulating aggregate demand to alleviate the impacts of a slowing economy. The RRR cut works in conjunction with the earlier liquidity injection through the "reverse-repo" operations. Both are parts of a concerted effort to avoid a sharp downturn in the economy by fine-tuning the policy tools.

More RRR cuts will take place in 2Q16 and 2H16. PBOC reiterated its stance of ensuring adequate liquidity in the banking system to boost economic growth. Given the moderating trend in inflation and the mounting pressure to expand liquidity, we expect PBOC to assume an accommodative approach to pursue stimulus measures and inject liquidity through different monetary tools in 2Q16 and 2H16. We forecast PBOC would lower RRR again and RRR cuts will be deployed as the principal tool to boost the economy.

Greater lending momentum to improve market sentiment. The major economic data demonstrated a slowdown of varying magnitude in recent months, sparking concerns that China's growth may moderate further amid uncertainties in global economy. We believe the latest RRR cut will increase lending momentum in 1H16 and lower the market risk premium.



China Economic Indicators

	2014		2015										2016			
	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb*
Real GDP (YoY%)	---	7.3	---	---	7.0	---	---	7.0	---	---	6.9	---	---	6.8	---	---
Export Growth (YoY%)	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)	(1.4)	(11.2)	(6.5)
Import Growth (YoY%)	(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)	(7.6)	(18.8)	(8.5)
Trade Balance (USD/bn)	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	60.9	63.3	58.8
Retail Sales Growth (YoY%)	11.7	11.9	10.7	10.2	10.0	10.1	10.6	10.5	10.8	10.9	11.0	11.2	11.1	11.1	11.4	
Industrial Production (YoY%)	7.2	7.9	6.8	5.6	5.9	6.1	6.8	6.0	6.1	5.7	5.6	6.2	5.9	5.7	5.7	
PMI - Manufacturing (%)	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	49.7	49.4	49.0
PMI - Non-manufacturing (%)	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	54.4	53.5	52.7
FAI(YTD) (YoY%)	15.8	15.7	13.9	13.5	12.0	11.4	11.4	11.4	11.2	10.9	10.3	10.2	10.2	10.0	10.1	
CPI (YoY%)	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	1.6	1.8	1.5
PPI (YoY%)	(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)	(5.9)	(5.3)	(4.8)
M2(YoY%)	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	13.3	14.0	13.8
New Lending (RMB/bn)	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	597.8	2,510	1,200
Aggregate Financing (RMB bn)	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	1,815.1	3,420	1,627.7

* Forecast (excluding PMI - Manufacturing & PMI - Non-manufacturing)

World Economic/Financial Indicators

Equity Indices				Global Commodities				Bond Yields & Key Rates			
	Closing price	Chg. WTD (%)	P/E	Unit	Price	Chg. WTD (%)	Volume (5-day avg.)		Yield (%)	Chg. WTD (Bps)	
U.S.				Energy				US Fed Fund Rate	0.50	0.00	
DJIA	16,516.50	(0.74)	15.01	NYMEX WTI	USD/bbl	34.11	4.06	592,452	US Prime Rate	3.50	0.00
S&P 500	1,932.23	(0.81)	17.49	ICE Brent Oil	USD/bbl	36.82	4.90	211,862	US Discount Window	1.00	0.00
NASDAQ	4,557.95	(0.71)	38.89	NYMEX Natural Gas	USD/MMBtu	1.70	(5.19)	79,387	US Treasury (1 Yr)	0.2084	(3.06)
MSCI US	1,834.97	(0.81)	18.04	Australia Newcastle Steam Coal Spot fob ²	USD/Metric Tonne	61.80	N/A	N/A	US Treasury (5Yr)	1.2318	(0.80)
Europe				Basic Metals				US Treasury (10 Yr)	1.7486	(1.37)	
FTSE 100	6,111.01	0.25	30.48	LME Aluminum Cash	USD/MT	1,596.25	1.22	19,510	Japan 10-Yr Gov. Bond	(0.06)	0.50
DAX	9,592.05	0.83	20.82	LME Aluminum 3 -mth. Rolling Fwd.	USD/MT	1,573.00	0.83	42,579	China 10-Yr Gov. Bond	2.9000	(1.00)
CAC40	4,365.61	1.18	20.27	CMX Copper Active	USD/lb.	4,705.50	(0.23)	11,265	ECB Rate (Refinancing)	0.05	0.00
IBEX 35	8,514.10	1.98	21.05	LME Copper 3- mth Rolling Fwd.	USD/MT	4,695.00	(0.23)	52,861	1-Month LIBOR	0.4385	0.50
FTSE MIB	17,723.50	1.37	862.3 31.52	Precious Metals				3 Month LIBOR	0.6351	1.69	
Stoxx 600	334.86	1.00	25.39	CMX Gold	USD/T. oz	1,239.60	1.57	213,819	O/N SHIBOR	1.9680	(8.00)
MSCI UK	1,778.67	0.05	31.86	CMX Silver	USD/T. oz	14.88	1.09	51,727	1-mth SHIBOR	2.7950	1.00
MSCI France	123.62	0.90	20.27	NYMEX Platinum	USD/T. oz	937.90	2.49	12,688	3-mth HIBOR	0.5810	(1.02)
MSCI Germany	124.44	(0.06)	#N/A N/A	Agricultural Products				Corporate Bonds (Moody's)			
MSCI Italy	50.19	0.74	#N/A N/A	CBOT Corn	USD/bu	358.25	(0.35)	189,553	Aaa	3.88	(8.00)
Asia				CBOT Wheat	USD/bu	453.75	0.33	73,576	Baa	5.32	0.00
NIKKEI 225	16,085.51	(0.64)	17.72	NYB-ICE Sugar	USD/lb.	14.36	2.57	86,536			
S&P/ASX 200	4,922.25	0.87	22.27	CBOT Soybeans	USD/bu.	864.00	0.06	133,992			
HSI	19,407.46	0.22	8.69								
HSCEI	8,068.29	0.42	6.01								
CSI300	2,930.69	(0.59)	12.37								
SSE Composite	2,733.17	(1.23)	14.44								
SZSE Composite	1,681.47	(3.17)	38.86								
MSCI China	50.76	(1.28)	8.82								
MSCI Hong Kong	10,967.07	(1.08)	9.78								
MSCI Japan	785.62	(1.10)	13.93								

* As of 12:00 AM closing

Currency

	Euro/USD	GBP/USD	AUD/USD	USD/JPY	USD/CHF	USD/CNY	USD/HKD	USD/CNY NDF 12-mth Spot pr.
Spot Rate	1.0861	1.3943	0.7180	113.18	1.0005	6.5479	7.7726	6.7555
Chg. WTD (%)	(0.67)	0.52	0.76	0.72	(0.37)	(0.11)	0.06	0.53

Note:

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



Disclosures

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Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return - 6% \leq 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	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	$1.0 \leq$ 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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