2013 Macro Outlook

December 3, 2012

Paving the way for a better 2013

Amid the ongoing European sovereign debt crisis and insecurity over jobs, US, EU and Japan will continue on a subpar recovery while the only hope to turn things around remains with the Asian emerging countries, despite the moderating growth we see in 2012. Although shaky, we expect the global economic recovery to gain momentum moving into 2013.

Within the group, China remains one of the strongest players. The trough of the economic cycle was seen in 3Q12 and we look for solid growth momentum at 8.1% in 2013 underpinned by accelerating consumption and investment as well as stable export growth. In general, market direction across assets will continue to depend on key macro risks including European sovereign debt crisis, pace of China economic recovery and fiscal cliff facing the US economy.

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Global economic outlook for 2013

Uneven economic recovery

Following 2010-2011 of anaemic and uneven recovery from the global financial crisis, the world economy was on the brink of another major downturn in 2012. Output growth has already slowed considerably during 2012, especially in the developed countries. In 2013, moderate growth recovery amid large spare capacity suggests little scope for inflation. The avoidance of global recession and subdued unit labor costs will support corporate profitability, particularly in developed economies. Gradual recovery accompanied by stable inflation expectations allows central banks to maintain current accommodative policy stances for longer, limiting the possibility for monetary policy-induced market dislocations in the period ahead. Our baseline forecast foresees continued improvement in economic momentum on a mild basis in 2013.

In 2013, economic recoveries across the world economy are expected on uneven basis with Europe and Japan being the notable laggards while the US enjoying slow but stable recovery. The US economy is still facing slower-than-expected drop of unemployment rate. Abundant liquidity conditions and recovery of housing market will pull the US economy out of economic downturn, thus leading to stable recovery. In Europe, most Eurozone countries still face fiscal retrenchment, structural adjustment, and banking sector weakness which remain significant drags on economic activities in the next several years. We believe Eurozone's economic activities will contract by 0.6%. In Japan, deflation, a strong yen, weak export markets, poor corporate profitability and China-Japan tense relations continue to restrain the growth momentum. Japan's growth will technically rebound to 2.2% due to low-base effect. Developing countries are expected to enjoy economic recoveries after a year of credit and fiscal loosening.

China, the second largest economy in the world, will recover from economic slowdown in 2012. After the GDP growth bottomed out in 3Q12, we expect China economic momentum will accelerate with more accommodative stimulus policies to support recovery in consumption and investment. Hong Kong economic growth is expected to rebound to 3.5% from 1.8% in 2012 given that external turmoil is alleviating. Consumption and investment are likely to be the positives growth drivers in 2013.

Global economic forecasts

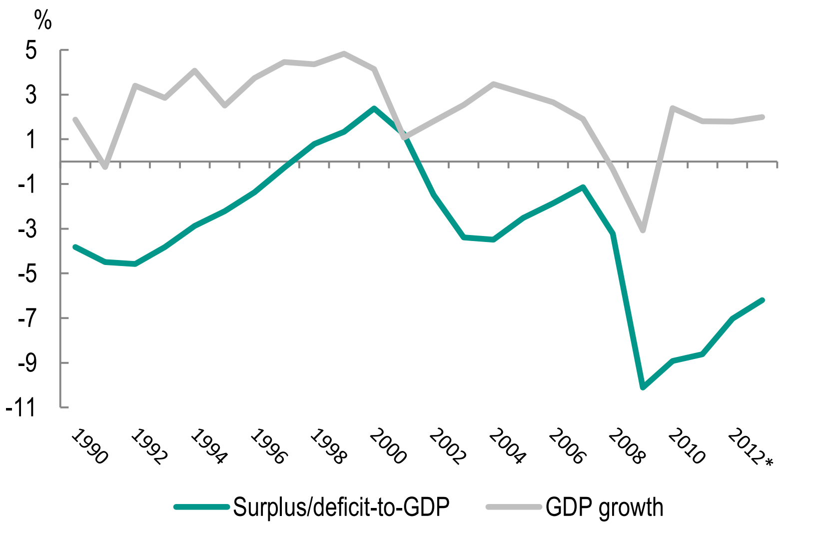
	2010	2011	2012F	2013F
US	2.4	1.8	1.8	2.0
Euro Area	2.0	1.4	(0.6)	(0.2)
Germany	4.0	3.1	0.9	1.2
France	1.7	1.7	0.2	0.5
Italy	1.8	0.4	(2.1)	(1.0)
Spain	(0.3)	0.4	(1.5)	(1.5)
Netherlands	1.6	1.1	(0.4)	0.3
Greece	(3.5)	(6.9)	(6.0)	(4.5)
Portugal	1.4	(1.7)	(2.8)	(1.5)
Ireland	(0.8)	1.4	0.5	1.5
UK	1.8	0.8	0.2	1.2
Japan	4.5	(0.8)	2.2	1.5
Mainland China	10.3	9.3	7.8	8.1
Hong Kong SAR	6.8	4.9	1.8	3.5
Singapore	14.8	4.9	2.3	3.3
South Korea	6.3	3.6	2.5	3.5
Russia	4.3	4.3	3.5	3.8
India	10.1	6.8	5.3	6.0
Brazil	7.5	2.7	1.8	3.8

Source: IMF, ABCIS estimates

US – fiscal cliff remains as the major risk

The US economic outlook in 2013 is not only shadowed by the re-election of President Obama, with no change in congressional control, but also the expiration of enormous tax cuts and transfer payments – "the fiscal cliff" — US$600bn in tax increases and spending cuts that will occur on Jan 1, 2013. These fiscal stimulus measures including the Bush-era tax cuts, the 2010-2011 payroll tax cut and extended unemployment insurance benefits, will expire at the beginning of 2013. They amount to about 4% to 5% of the US GDP. Taxes imposed by the Obamacare reforms will add to the fiscal punch. The fiscal cliff could knock 4.5% off 2013 growth if all tax cuts and transfer payments were allowed to expire and spending cuts where triggered. But we believe the outcome of Congress will likely reach a deal to avoid the fiscal cliff so as to avoid recession and big swings in the US financial markets.

US deficit-to-GDP is still at high level



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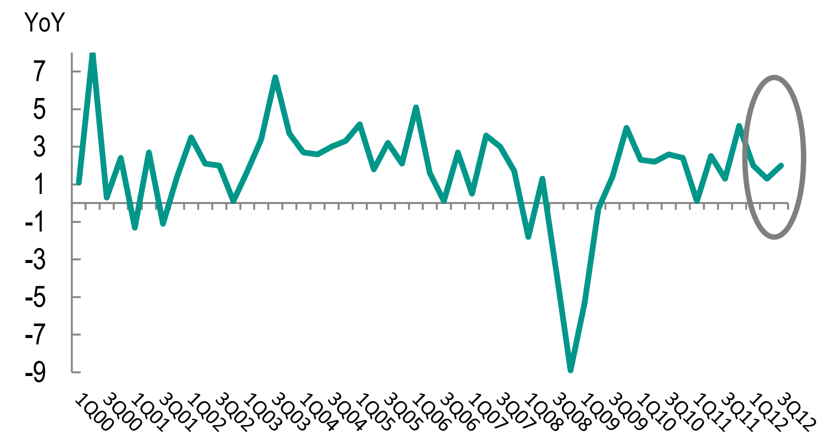
Source: Bloomberg , ABCIS estimates

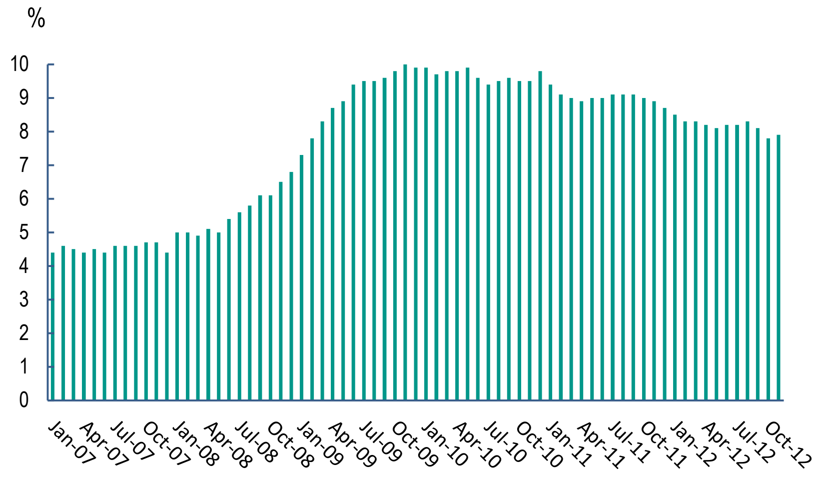
US economic growth slumped in 2Q12 but turned stable in 3Q12



Source: Bloomberg

With the new round of QE in place, we believe liquidity no longer poses a problem for the US economy. Though political leaders around the world have voiced their concerns over the US heavy borrowing and the possible devaluation of its currency, it appears that they remain the willing buyers of US debt, albeit at very low yields. Although current data indicate a faster pickup in the US economy, we believe the recovery still faces significant headwinds highlighted by the slower-than-expected housing recovery and the weak job market. These will hinder any pickup in sentiment among business owners, investors and consumers. The US recovery in 2013 is expected to be sluggish and we forecast the US economy grow at 2.0%.

US unemployment rate remains above 7%



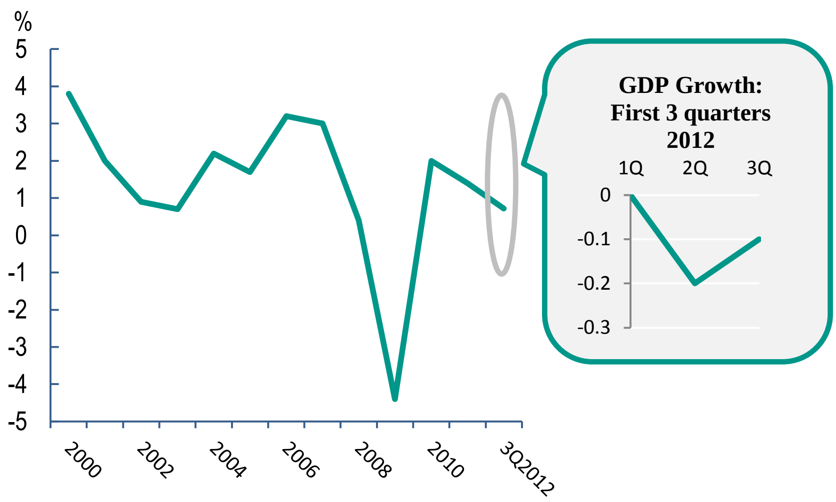
Source: Bloomberg

Europe - a more prolonged recession than expected

Growth in the euro area has slowed considerably since the beginning of 2012. Even under the optimistic assumption that the debt crises can be contained within a few countries, growth is expected to be only marginally positive in the euro area, with the largest regional economies dangerously close to renewed downturns and the debt-ridden economies in the periphery either in or very close to a protracted recession. The Eurozone recovery has been underwhelming and fragile due to the continued concerns of the financial position of the region. Economic growth momentum in the Eurozone remains frail, with the debt crisis still hanging over the region. With both fiscal and monetary austerity measures around the corner, we expect to see some negative effects on the growth momentum in the region. The Eurozone is set to see slower growth due to the uncertainty in the policy landscape.

The rapidly cooling economy is both a cause and an effect of the sovereign debt crises in the euro area, and of fiscal problems elsewhere. The crises aggravate the weaknesses in the balance sheets of banks sitting on related assets. Although the ECB and the IMF have played a bigger role in fighting the euro zone sovereign debt crisis through more rate cuts, bond purchases and further liquidity provision, the fiscal austerity measures taken in response are further weakening growth and employment prospects, making fiscal adjustment and the repair of financial sector balance sheets all the more challenging. Weak economic fundamentals will lead to another negative economic growth of 0.2% in 2013 in Euro zone.

Euro Zone's economic activities contracted in 2Q12 and 3Q12

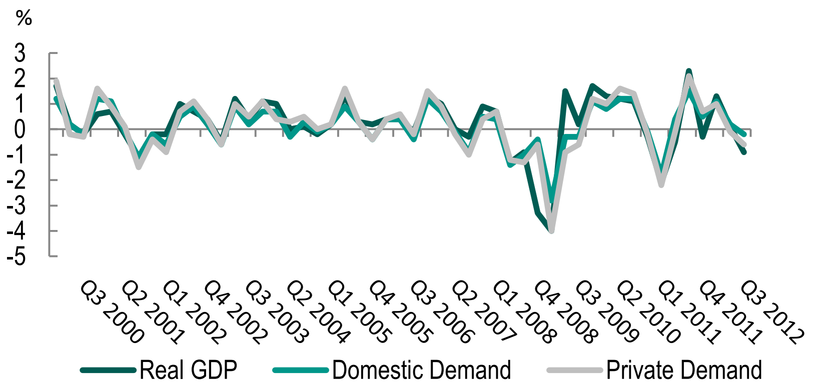


Source: Eurostat

Japan – sluggish economic recovery

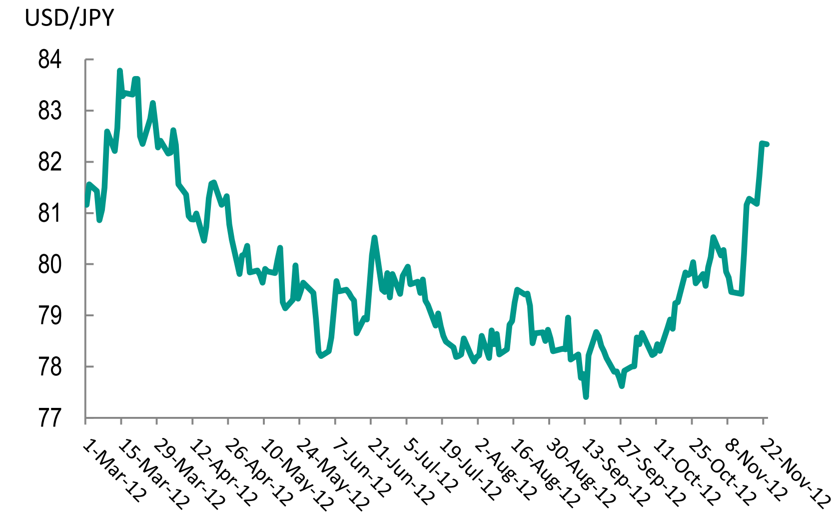
Post-quake reconstruction is expected to lift Japan's GDP growth to about 2 per cent per year in 2012 and 2013. However, low-base effect has led to expected above 2% economic growth in 2012 but risks remain on the downside in 2013, emanating from the challenges of strong yen, tense relations after standoff over disputed islands with China and synchronized downturn along with other major developed economies. The impetus for Japan's economic recovery comes from the recovery of the global economy and surging demand in its major export markets. However, the debt crisis in the Eurozone dampens demand of Japanese exports, while the undesirable strength of the Yen has further hindered Japan from achieving a strong economic recovery. Although Bank of Japan has intervened in the market to curb the Yen from shooting up further through quantitative easing, the Japanese currency still stands at a high level against major currencies and this will slow the economic recovery of Japan.

Japan's economic growth remains sluggish



Source: Bloomberg

Yen needs more depreciation



Source: Bloomberg

Emerging Asia - bracing for recovery

In 2012, emerging countries in Asia are seriously affected by the economic woes in developed countries through trade and financial channels. The global crisis has alarmed emerging markets the risk of heavily dependence on exports. Emerging economies, such as China and Singapore, have aggressively shifted their growth driver from exports to domestic demand. The combination of vibrant domestic demand, bridging trade links across emerging markets, as well as local policy flexibility have put emerging economies in a better position in 2013 to achieve economic decoupling from developed economies.

Economic growth forecast for emerging Asian economies

YoY%	2010	2011	2012F	2013F
India	10.1	6.8	5.3	6.0
South Korea	6.3	3.6	2.5	3.5
Singapore	14.8	4.9	2.3	3.3
Malaysia	7.2	5.1	4.4	4.7
Thailand	7.8	0.1	5.6	6.0
Indonesia	6.2	6.5	6.0	6.3
Vietnam	6.8	5.9	5.1	5.9

Source: IMF, ABCIS estimates

Macroeconomic fundamentals continue to be superior in the emerging market universe. We expect steady economic growth in the emerging markets to be an offset to the otherwise slowing global growth environment. The current strength of Asian currencies has shown strong evidence of an influx of liquidity into Asian economies since 3Q2012. Look into 2013, we forecast growth recovery and tapering inflation be the main themes for the Asia story while buoyant domestic consumption and intra-regional trade will be the major growth drivers.

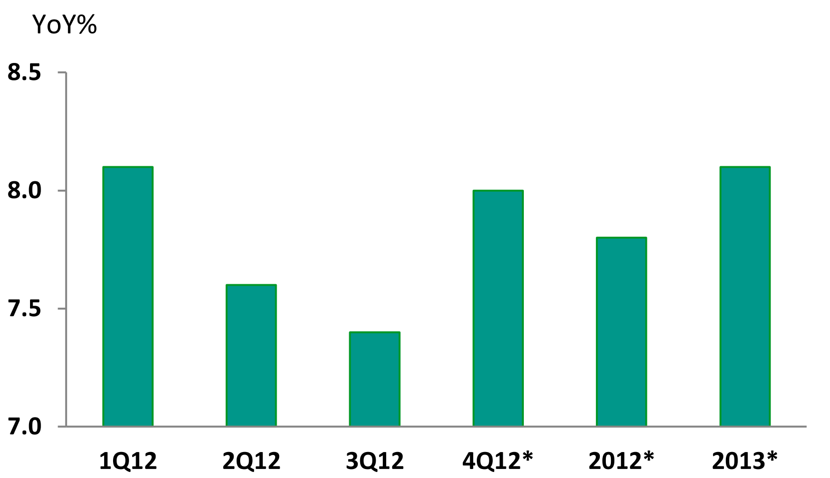
China economic outlook for 2013

2012 is marked by high global volatility and slowdown in economic activities in China. Yet despite disinflation and the headwinds facing China's exports, we see a brighter path ahead as the government implements aggressive fiscal and monetary stimulus measures, including investment incentives for strategic sectors, consumption and social housing subsidies. We believe economic growth bottomed out in 3Q12 and that there will be a resurgence in investor confidence and growth momentum in 4Q12 and 2013.

China's economic growth has stabilized and forward-looking economic indicators point to a modest acceleration in domestic demand. Investments will continue to override consumption as China's main growth driver in 2013, especially in 1H13. Other positives are stable appreciation of the renminbi and improvement of external trade flows. The negative impact of the US fiscal cliff on external demand will be mainly felt in late 2012 and 1Q13 and China policy makers will remain cautious in exercising expansionary economic policies to withstand external turmoil.

The stabilization of economic conditions has made aggressive policy easing less necessary. The direction of prudent policy loosening remains unchanged. We believe the PBOC will maintain abundant liquidity through reverse repos and interest rate liberalization in 2013. Fiscal policy should remain expansionary and infrastructure investment should continue to grow relatively fast. We look for stable economic recovery: YoY GDP growth to rebound to 8.0% in 4Q12 and growth next year to be 8.1%.

China economic growth for 2012 and 2013



** forecast*
Source:Bloomberg, ABCIS estimates

Economic forecasts for China

% (otherwise stated)	2011	1Q12	2Q12	3Q12	4Q12F	2012F	1Q13F	2013F
Real GDP	9.2	8.1	7.6	7.4	8.0	7.8	7.9	8.1
FAI(YTD)	23.8	20.9	20.4	20.5	21.2	21.2	22.0	22.5
Retail Sales	17.1	14.8	14.0	13.8	14.1	14.4	14.4	15.2
Exports	20.3	7.6	10.5	4.5	8.5	7.7	4.0	8.2
Imports	24.9	7.1	6.5	1.6	2.8	4.4	2.5	7.0
Trade Surplus (US bn)	155.1	1.1	68.8	79.5	78.5	227.9	7.6	268.4
CPI	5.4	3.8	2.9	1.9	2.0	2.6	3.0	3.2
PPI	6.1	0.1	-1.4	-3.3	-2.3	-1.7	0.5	2.0
M2	13.6	13.4	13.6	14.8	14.5	14.5	14.5	15.0
1-year deposit rate	3.50	3.50	3.25	3.00	3.00	3.00	3.00	3.00
1-year lending rate	6.56	6.56	6.31	6.00	6.00	6.00	6.00	6.00
Deposit RRR	21.0	20.5	20.0	20.0	20.0	20.0	20.0	20.0
Exchange Rate (USD/RMB)	6.30	6.29	6.35	6.28	6.20	6.20	6.14	6.08

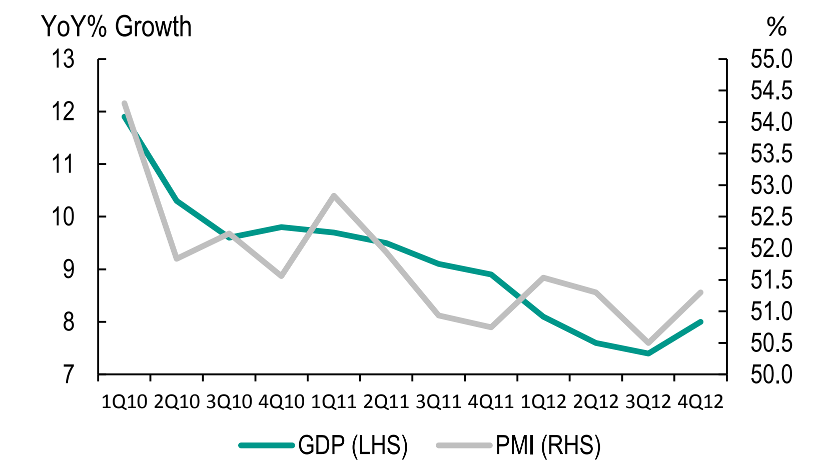
Source: Bloomberg, ABCIS estimates

Best and worst case scenario for China in 2013

Scenarios	Worst case	Base case	Best case
Possible events	Negative trade growth Eurozone member bankruptcy Failure to avoid fiscal cliff	High single-digit trade growth No signs of Eurozone debt worsening or contagious to other regions Avoidance of the US fiscal cliff	Double-digit trade rate Eurozone debt repayment foreseeable Faster-than-expected US recovery
Real GDP (%)	7.0	8.1	9.0
Retail sales	12.0	15.2	17.2
FAI (YTD)	17.0	22.5	24.5
CPI (%)	2.0	3.2	4.0
Exports	(12.5)	8.2	15.5
Imports	(8.5)	7.0	13.5

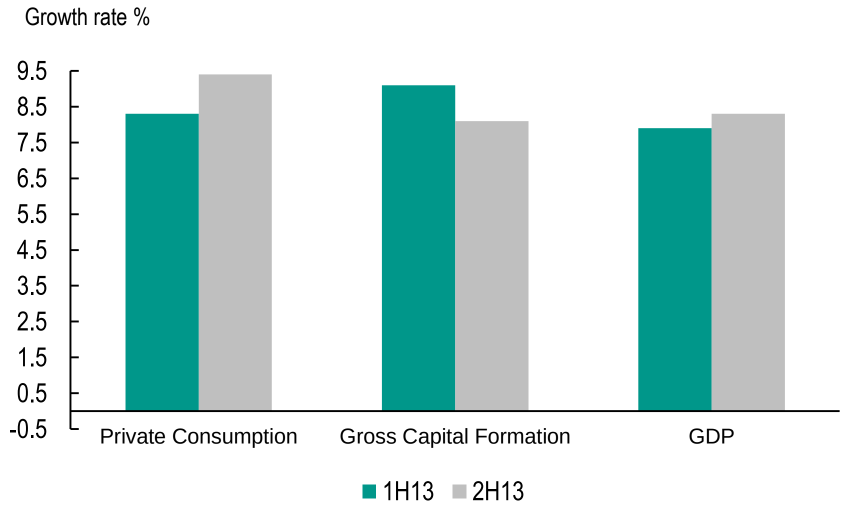
Source: ABCIS

Signs of economic recovery: surging PMI



Source:Bloomberg, ABCIS

Investment growth leads 1H13 while consumption growth picks up in 2H13



Source:Bloomberg, ABCIS

China policy outlook for 2013

In accordance with China's economic growth and structural adjustment objectives, we estimate that the central government will implement a policy characterized by prudent monetary easing and aggressive fiscal expansion. The PBOC will continue to conduct monetary easing measures to support economic recovery while keeping inflation at the range of 3% to 4%. Meanwhile, both the central government and local governments will put in place more supportive fiscal policies to boost investment and development in infrastructure and new strategic industrial sectors. Regional and rural infrastructure and investment in utilities as well as subsidized housing construction will continue to obtain government funding and bank lending support. In sum, China will continue to fine-tune the current accommodative macroeconomic policies to boost growth in 2013.

1. Monetary policy: prudent and accommodative liquidity management

Prudent liquidity management remains intact

Prudent liquidity management will continue to be a priority of monetary policy in 2013. Since the US and other developed economies launch QE measures in 2012, we believe that international capital will continue flowing into China, which would exert greater pressure on the PBOC to manage liquidity. In our view, monetary policy will be prudent to accommodate the market demand for liquidity. The PBOC would like to keep financial conditions accommodative for growth stabilization by injecting more liquidity into the inter-bank market through reverse repo, which helps the early recovery signs gain more traction. Accordingly, we expect the annual new bank loans target will be between RMB9.0t and RMB 9.5t in 2013 from 2012's target of RMB8.5t and, consequently, the target for M2 growth will be 15% YoY against 14.5% in 2012.

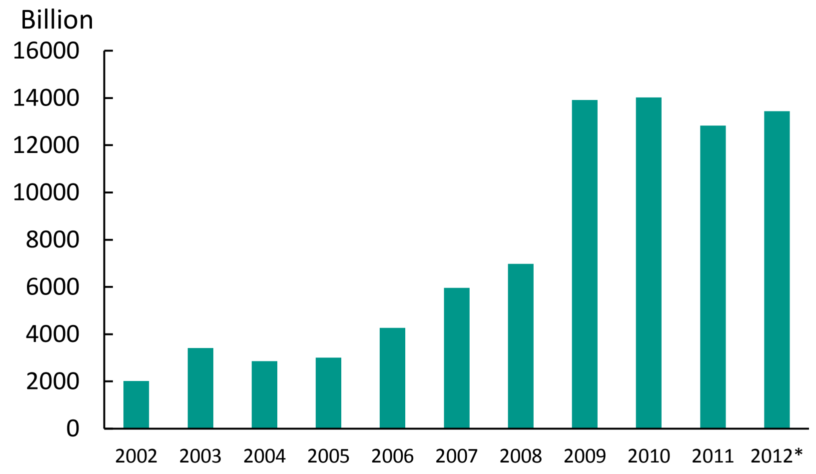
Monetary easing through reverse-repo and interest rate liberalization. Following several rounds of RRR and interest rate cuts in 2012, we believe China will stick to 'wait-and-see' approach to conduct further credit loosening in 2013. Although China has shifted its focus to reviving the economy from containing inflation, QE measures have raised concerns about possible return of inflation. Therefore, we believe the PBOC will use reverse-repos rather than RRR cut to inject liquidity into banking system. We may also see an additional widening in the floating range of lending rates through the deepening of interest rate liberalization in an attempt to lower borrowing costs of Chinese enterprises. This also replaces the traditional interest rate cut. In sum, both monetary easing measures are more flexible to accommodate the demand for capital in 2013.

The PBOC expects prudent liquidity management

	Inflation (target) (%)	Inflation (Actual) (%)	Over /Under the target	Monetary policy stance
2007	3	4.8	Over	Prudent + liquidity management
2008	5	5.9	Over	Tightening
2009	4	(0.7)	Under	Moderately loose
2010	3	3.2	Over	Moderately loose
2011	4	5.5	Over	Tightening
2012	3	2.6	Under	Prudent + liquidity management
2013F	3	3.2	Over	Prudent + liquidity management

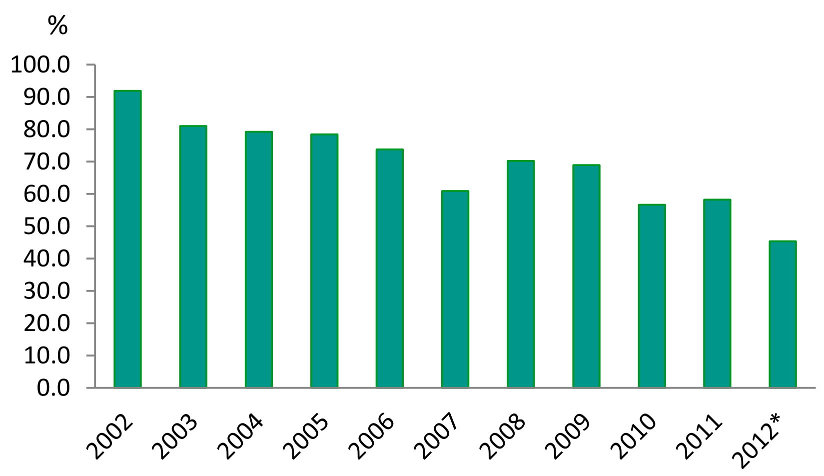
Source: ABCIS research

Total social financing surges in 2012



**forecast*
Source:Bloomberg, ABCIS estimates

Share of new loans within total social financing is diminishing



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Source:Bloomberg

Table of recent reverse-repo operations

Date	Quantity	Interest rate (%)
7days		
6-Sep-12	200.00	3.35
11-Sep-12	450.00	3.35
13-Sep-12	350.00	3.35
18-Sep-12	200.00	3.35
20-Sep-12	550.00	3.35
9-Oct-12	1,650.00	3.35
11-Oct-12	120.00	3.35
16-Oct-12	180.00	3.35
18-Oct-12	200.00	3.35
23-Oct-12	490.00	3.35
25-Oct-12	1,400.00	3.35
30-Oct-12	2,900.00	3.35
1-Nov-12	580.00	3.35
6-Nov-12	1,660.00	3.35
8-Nov-12	650.00	3.35
13-Nov-12	780.00	3.35
15-Nov-12	420.00	3.35
20-Nov-12	690.00	3.35
22-Nov-12	460.00	3.35
14 days		
6-Sep-12	200.00	3.50
11-Sep-12	320.00	3.45
25-Sep-12	1,000.00	3.45
27-Sep-12	500.00	3.45
11-Oct-12	470.00	3.45
18-Oct-12	100.00	3.45
25-Oct-12	850.00	3.45
1-Nov-12	1,150.00	3.45
8-Nov-12	800.00	3.45
15-Nov-12	490.00	3.45
22-Nov-12	430.00	3.45
28 days		
13-Sep-12	200.00	3.60
18-Sep-12	550.00	3.60
20-Sep-12	1,050.00	3.60
25-Sep-12	1,900.00	3.60
27-Sep-12	1,300.00	3.60
9-Oct-12	1,000.00	3.60
16-Oct-12	580.00	3.60
23-Oct-12	420.00	3.60
30-Oct-12	1,050.00	3.60
6-Nov-12	1,110.00	3.60
13-Nov-12	1,080.00	3.60
20-Nov-12	450.00	3.60

Source: The PBOC

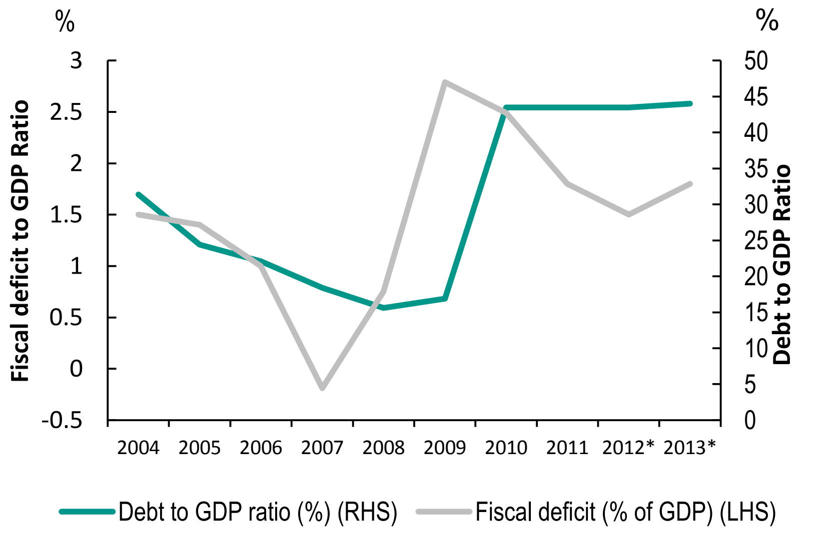
2. Fiscal policy: boosting FAI to support growth momentum

Fiscal expansion remains as the main driver of economic growth

The central government will continue to adopt expansionary fiscal policy to boost FAI investment as such a move would be consistent with its objective of transforming the nation's industrial structure over the medium term. In our view, the central government will primarily support infrastructure investment in highways and railway construction, electricity grid upgrades, resource development in the central and the western provinces and agricultural reforms, which are in line with the "four new modernizations" - industralization, informatization, urbanization, and modernization of agriculture outlined in the 18th Congress. The central government will also continue to monitor the construction of subsidized housing partly funded by local governments. We also expect the government to provide more subsidies and raise average income for low-income communities, aiming to establish salary and social welfare adjustment mechanisms linked to economic growth and CPI movement.

Fiscal stimulus remains intact in 2013. In order to further facilitate the recovery of economy, we expect more simulative packages to emerge in a more aggressive manner in 2013, such as: (1) acceleration in approvals for infrastructure and construction projects; (2) additional subsidies on energy-efficient consumer products; (3) encouraging private capital to flow into large industrial sectors that normally dominated by state firms with high entry barriers; (4) tax reform to support the service sector;

China fiscal position is still healthy



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Source: Bloomberg

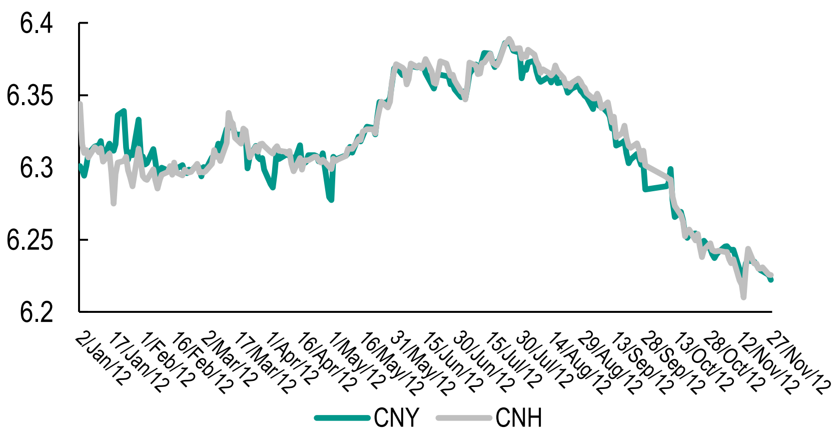
3. Stable pace of renminbi appreciation in 2013.

The pace of renminbi internationalization will accelerate with 2% renminbi appreciation in 2013

During the first three quarters of 2012, the stronger dollar, the debt crisis in the euro zone and weaker-than-expected Chinese economic indicators combined to lead to depreciation of the renminbi. The turn has come when economic indicators showed the bottoming of economic activities in 3Q12, which led to a strong rebound of the renminbi in 4Q12. We expect the renminbi will have a mild appreciation of 1% to 1.5% in 2012.

In 2013, the PBOC will further gear up forex liberalization by widening the trading band of the renminbi against the US dollar and facilitating interest rate liberalization. The growth recovery in China is likely to keep the rising pace of the renminbi and we look for 2% appreciation in 2013.

CNY vs CNH



Source: Bloomberg

Seven economic themes for 2013

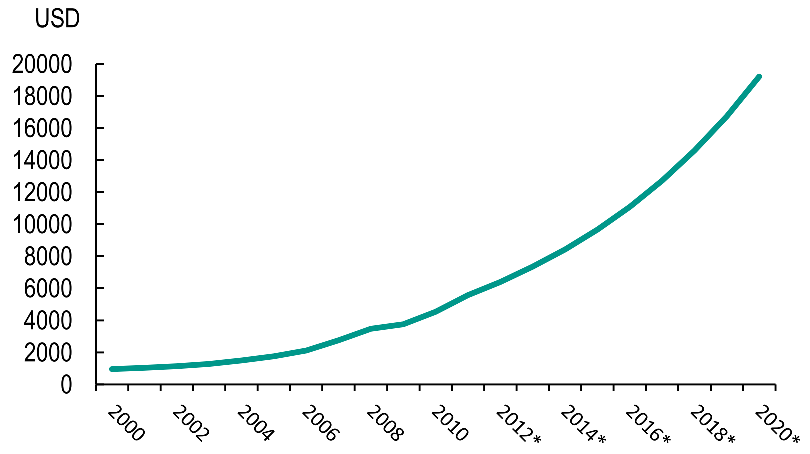
1. Reform agenda - "Four New Modernizations"

"Four New Modernizations" become the major economic drivers in the coming decade

The 18th Communist Party Congress ended on November 14 2012 and approved a new leadership committee and confirmed the seven members of the Party's Politburo Standing Committee. President Hu Jintao outlined the reform and development agendas for the party and the country in the coming decade. We believe the proposal of "four new modernizations" including industralization, informatization, urbanization, and modernization of agriculture is of paramount importance in driving China economic growth in the coming decade.

In recent years, China has shifted away from using an export-led growth model to a more balanced model that leans towards domestic investment and consumption. Structural economic transition in China will likely be gradual and lengthy. The transition will lead the economy to a slower but more sustainable growth while consumption and service sectors should benefit from the transition. As China is stressed to improve the socialist market economy by changing of growth drivers from export to consumption, boosting domestic demand and deepening economic reforms through "four new modernizations" will help China sustain economic growth in coming decade. Industrialization and informatization target to modernize the business models of China industries by moving away from OEM models. Urbanization will promote resident migration and infrastructure development which enhance job creation and consumption growth. Modernizing agriculture sector helps increase its economic contribution to China and improves social well-being of farmers. We believe the "four new modernizations" will further alter economic fundamentals of China. In our view, GDP growth can be maintained between 7% and 9% in the next 8 years and China can achieve the target of doubling GDP and income of urban and rural resident per capita of 2010 in 2020.

Per capita GDP growth 2010 to 2020



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Source: Bloomberg, ABCIS estimates

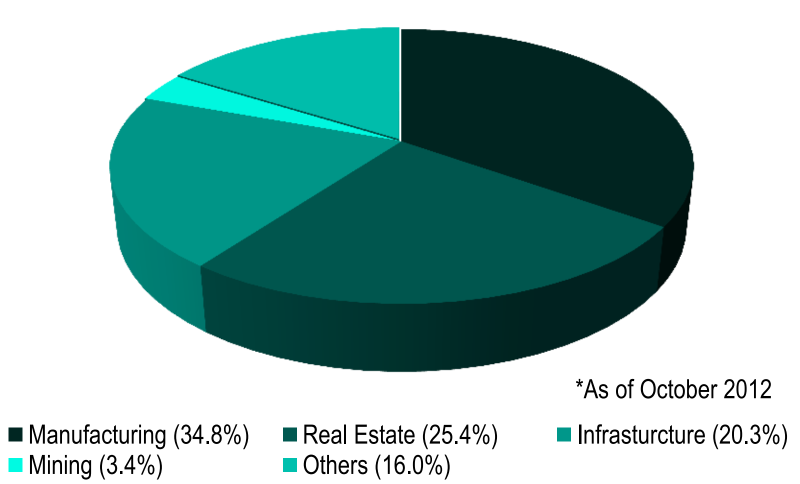
2. Growth recovery still addicted to investment and credit

Investment still contributes most to economic growth, especially in 1H13

While the Chinese economy transitions from an export-driven model to one that is consumption-driven, it will have to rely more heavily on investment to "stabilize growth" during a recovery phase of economic cycle. In 2008 relaxed credit policies towards the private property market led to a real estate boom. We believe the central government is not keen to allow this to happen again and has repeatedly stressed its determination to curb rising property prices. With private property out-of-bounds as an investment target, the only options left for large-scale government investment are infrastructure, social security housing and services. The data we have examined indicates FAI growth in these sectors has been on the rebound since 2Q12. Thus more selected allocation of FAI projects may have a proportionally larger impact on growth and we expect the momentum to sustain in 1H13.

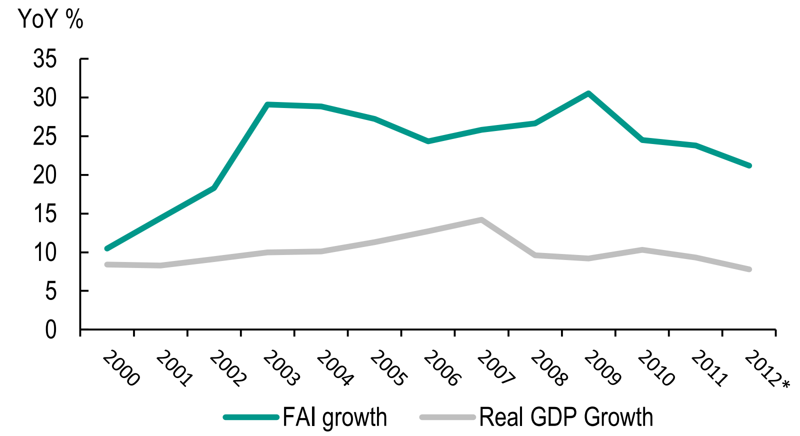
By sector, infrastructure, social security housing and services are likely to remain key drivers. The theme of enhancing 'urbanization' increases demand for infrastructure investment with which local governments lead the charge implementing new rounds of stimulus, mainly towards local infrastructure and manufacturing projects. Social security housing investment will boom in 2013 as at least 5 million units are planned to be constructed. Services investment such as healthcare will return to above-trend growth as it will get a boost from projects in the 12th FYP. Manufacturing is on a secular slowdown but is likely to stabilize in 2013. Over the next few quarters, we expect more investment-related stimulus to be announced, which should attract FAI. The government is keen to maintain FAI over 20% YTD YoY in 2013 to support economic growth.

FAI breakdown by sector



Source: Bloomberg

FAI growth maintains above 20%



**forecast*
Source: Bloomberg

Summary of local government investment plans since July, 2012

Time	Province/city	Details
16 July 2012	Ningbo (Zhejiang)	26 policies to accelerate industrial reconstruction and tax reform
23 July 2012	Nanjing (Jiangsu)	Issues policies to expand domestic demand and encourage consumption on real estate, the auto industry, tourism and entertainment
23 July 2012	Guizhou	RMB3t (over 10 years) focusing on tourism and infrastructure
25 July 2012	Changsha (Hunan)	RMB829b over 3 years across 195 large and 155 medium-sized projects
20Aug 2012	Chongqing	RMB1.5t over the next 3 years on 7 strategic industries
21Aug 2012	Tianjin	RMB1.5t on 10 industries including petrochemicals, port equipment and new materials
23Aug 2012	Guangdong	RMB1t in 177 projects related to ocean resource development

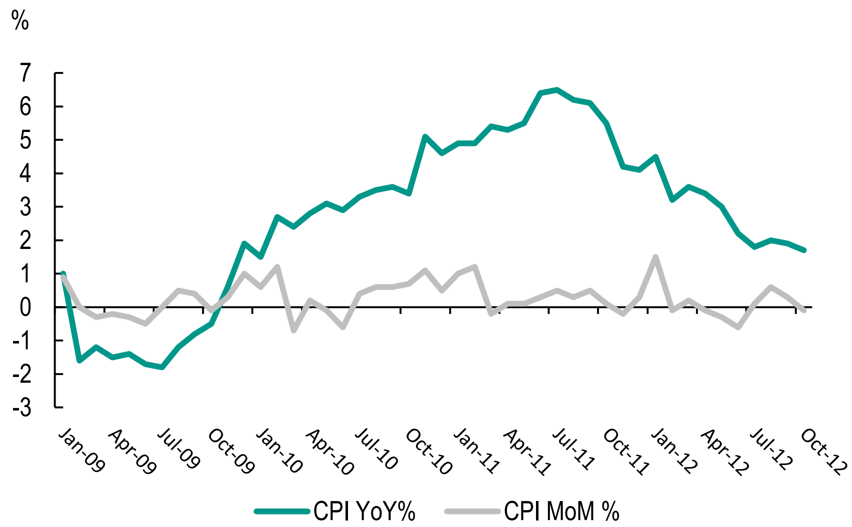
Source:ABCIS

3. Inflation : Higher but still manageable

Inflation will accelerate above 3%, which is in line with pick-up of economic activities.

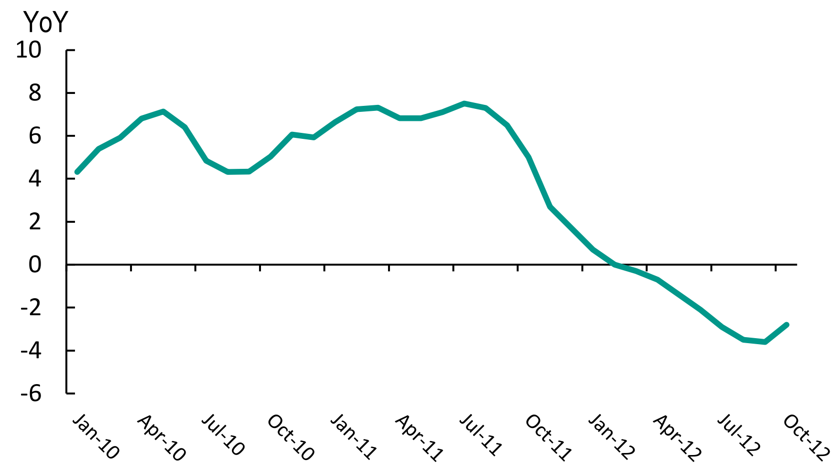
Inflation has turned from a minor concern into a critical policy goal in a matter of several months in 2012. The emergence of QE3 raised concerns on surging commodity prices which have direct impact on China's inflation. Shortly after the announcement of QE3 we saw a sudden dip in the US dollar and a surge in commodity prices; turnover in the equity markets accelerated and investor sentiment picked up. The previous two rounds of QE have resulted in higher inflation in China. For instance, shortly after QE1 and China's injection of RMB4t into the macro economy in 2008, CPI inflation in China began to rise from a low of -1.9% in July 2009 to a peak of 2.7% YoY in March 2010 while PPI also shot up from -8.2% to 5.9% YoY during the same period.

The trend of CPI inflation becomes stable



Source: ABCIS

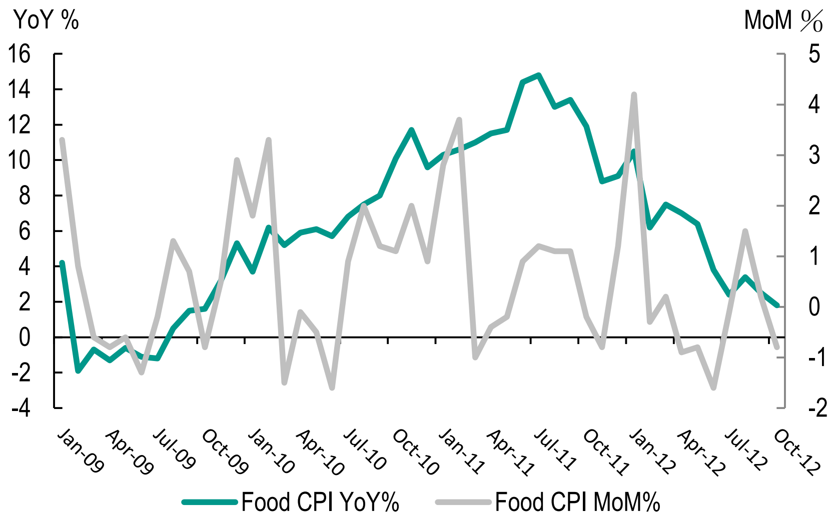
PPI bottomed and showed signs of acceleration



Source: ABCIS

Food will probably remain the principle driver of inflation. Surging food and commodity prices create upward inflationary pressure. As we know from the most recent two rounds of QE, speculative trading in food and commodities spiked up on the expectation of greater liquidity in the economy. We consider rising food prices the primary risk factor for spiraling inflation. The PBOC, keen to avoid such wild swings in inflation, will adopt a prudent approach to structuring monetary stimulus.

Food inflation turns stable



Source: ABCIS

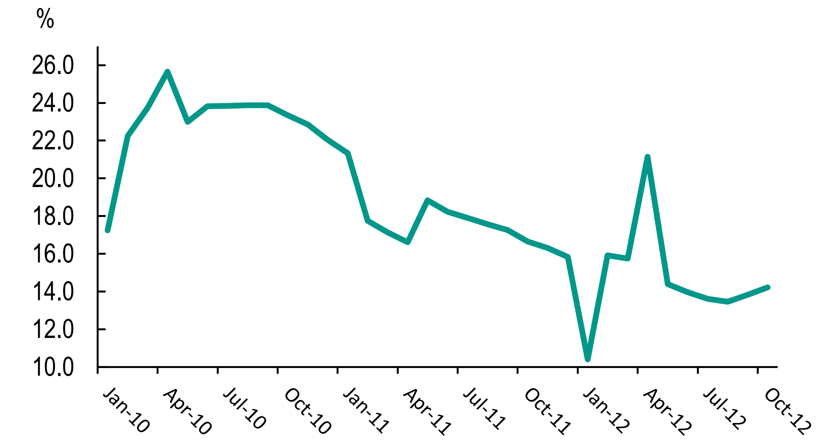
With liquidity flowing into China in the wake of QE3, the PBOC is less likely than ever to turn to aggressive monetary stimulus measures like RRR or rate cuts, even if the economy continues to slow. The PBOC is likely to maintain a cautious approach to stimulus in view of the sudden gush of liquidity pouring into the macro economy. Investors should not hold their breath for either an RRR or a rate cut and this leaves reverse repos as the tool of choice for injecting liquidity when required. We expect the PBOC to engage in limited and highly targeted stimulus measures designed to prop up specific sectors. We expect inflation of China will be in the range of 3% to 4% in 2013.

4. Consumption's climb, surely but in 2H13

Consumption growth will see stable growth in 1H13 and will surge in 2H13 amid rising wage growth and improved economic sentiment

Weaker-than-expected retail sales growth in 2012 has been one of the key reasons to cause moderating GDP growth in 2012. The slowdown of retail sales is due to factors including slower-than-expected wage growth, shrinking wealth effects from underperformed A-share market and economic uncertainty arising from change of new leadership. Looking forward into 2013, we believe improving economic fundamentals and launch of consumption-stimulus policies will restore a trend growth of consumption in 1H13 and consumption will surge in 2H13.

3MA retail sales growth demonstrated stabilizing trend

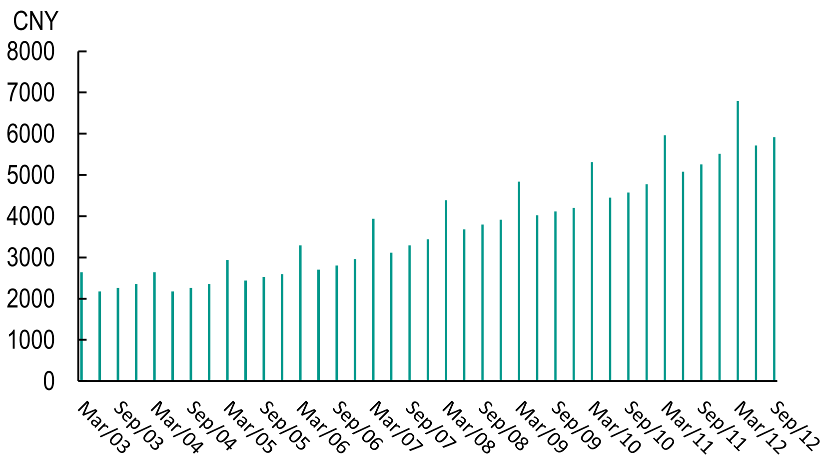


Source: Bloomberg, ABCIS

Income growth is the main driver to stabilize consumption. Relatively fast and stable income growth allows for a more stable pace of consumption growth. We see a gradual recovery of retail sales in October 2012 to 14.5% YoY from 13.1% in July 2012. Our estimate calls for 14.4% YoY growth and 15.0% YoY growth in 2012 and 2013 respectively on the back of tamed inflation, growing individual income and upcoming national stimulus policies intended to boost domestic consumption in 2013. From a national strategic perspective, China has highlighted consumption as the primary driver of economic growth in China in the coming ten years and we expect a string of consumer-related fiscal policies will be introduced in 2013.

With significant government subsidies being injected into the agricultural sector and minimum wage increases seen in most provinces, we estimate the average wage in China will see double-digit growth in 2013, driving up general purchasing power and private consumption.

Stable growth of personal disposable income of urban household



Source: Bloomberg

We believe that policymakers have realized that the key to improve consumption affordability and inclination is to optimize the country's income structure by raising average income for the middle- and low-income segments. Raising household per capita disposable income is a priority. We expect the following measures to be introduced: (1) a threshold increase in personal income taxation; (2) establishment of a pay raise mechanism by linking local GDP and CPI indicators to government staff salaries; (3) increase in inflation-related subsidies aiding retired and lower income groups. These measures will reduce social dissatisfaction and improve social stability. More construction of economic housing is also high on the government's list of things to do over the medium term. In addition, the pace of urbanization and economic housing construction is expected to accelerate in 2013, while government budget's funds will be used to create more consumer demand for housing-related products. The government has also launched targeted policies for specific industries, including the furniture "go-rural" subsidy program to promote retail sales in rural areas.

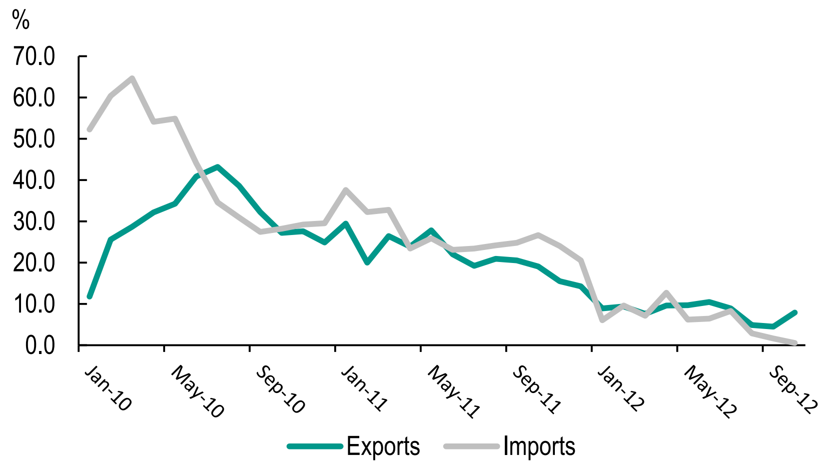
In the coming years, the drivers of income growth would be stronger, as China transitions through its "Lewis turning point". In 2012 and 2013, China's working age population as a share of the total would likely peak and be followed by a steady decline. This might not determine the passing of the turning point, but the rise of labor disputes and the increases in the minimum wage provide early signals for a market-driven rise in labor income that could have stronger impact on consumption.

5. Trade rebalancing remains intact

Amid the continuation of trade rebalancing and weakness of Europe market, exports growth will be in the range of 8% to 10% in 2013, significantly lower than 20% to 30% range in 2010 and 2011.

There is no doubt that China's exports can no longer sustain rapid growth, but correcting the trade imbalance would still take some time. Transformation of export mix is the only way to sustain export growth in China. In recent years, China exporters have faced tougher challenges, including rising wages and land costs. In simple economic terms, China is losing its competitive advantage, as well as its absolute advantage, in low-value manufacturing products, which are now easily replicated in countries that can put up with lower costs. To avoid seeing its export sector collapse, we believe China will shift its focus towards higher-end and more value-added products. We believe the machinery and transport equipment manufacturing sector is the only one that will see sustainable momentum.

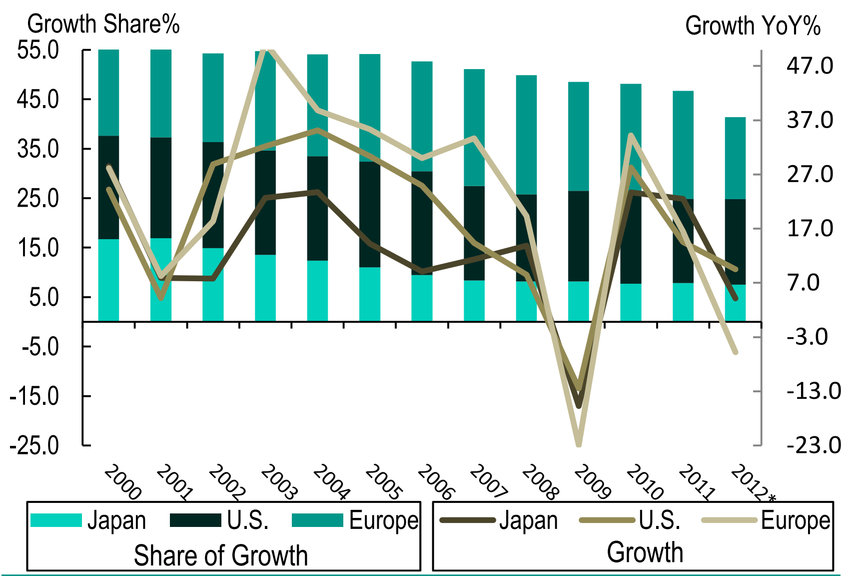
3MA export growth showed upward trend



Source: Bloomberg, ABCIS

China's exports to the US and emerging economies remain stable while economic slowdown in Europe and Japan reduce imports from China. Recent key economic indicators in the US suggest that fears that the US economy is heading to another recession are likely to recede. We expect US GDP growth to accelerate mildly from 1.8% in 2012 to around 2.0% in 2013. Slow US economic recovery has been largely attributed to accumulating business inventories, while consumption growth is still anemic, suggesting that households are still feeling the pinch from high unemployment rates, muted income growth and heavy debt burdens. Based on the outlook of US economic recovery in 4Q10 and 2011, we estimate that China's exports to the US will continue to grow at around 10% YoY in 2013.

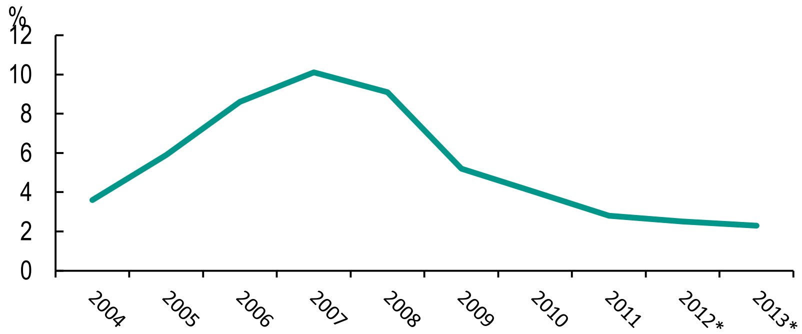
Growth and share of growth of China export to US, Europe and Japan



**forecast*
Source: Bloomberg, ABCIS estimates

The strongest headwind against China's exports is market saturation. China occupies significant shares of G20 imports. Even in Asian emerging markets, China's market share has risen to nearly 20%, similar to its share of G3 markets. Moreover, it is exceedingly difficult to make further advances amid rising wages and more intense competition from emerging economies. Also, export growth would be more bound by global economic growth which remains sluggish in 2013. We expect China export growth to be in the range of 8% to 10% in 2013, significantly lower than 20% to 30% range in 2010 and 2011.

Balance on current account (% of GDP)



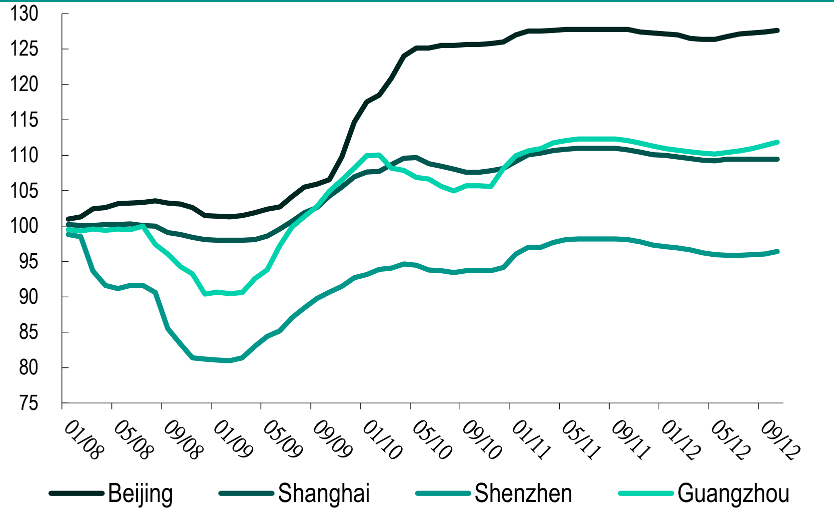
** forecast*
Source: Bloomberg, ABCIS estimates

6. Diminished property policy risks

General property tightening policies remains unchanged but strong demand will drive volume growth in 2013.

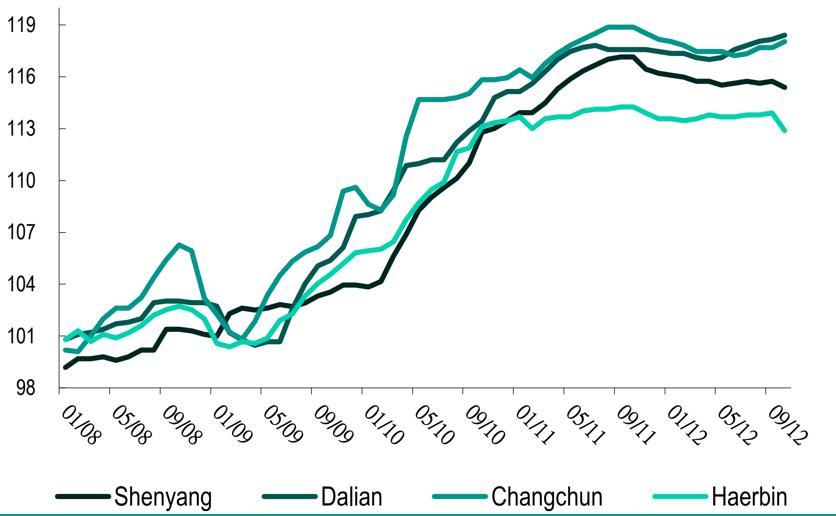
China's property market has faced extreme surge in the residential housing prices, becoming a matter of concern for the central government. The government's tightening measures to control the rising prices in the domestic real-estate market are laying more emphasis on promoting affordable housing in the country for the poor people and raising percentage of down payments for the first home buyers and ban of home loans for the third home buyers. The object of the maintaining policy tightening is to engineer a soft landing for China's property market. We expect sentiment to improve and volume to further pick up in 2013 after housing prices correct in 2012. Meanwhile, as housing prices approach more affordable levels, policy risks diminish and policymakers are more likely to lift some of the restrictive measures that have been the cause of an overhang in the housing market. Demand will return to the market once things loosen up a bit. We expect overall residential property prices will achieve a healthy single-digit growth in 2013.

China property price index: tier-1 cities



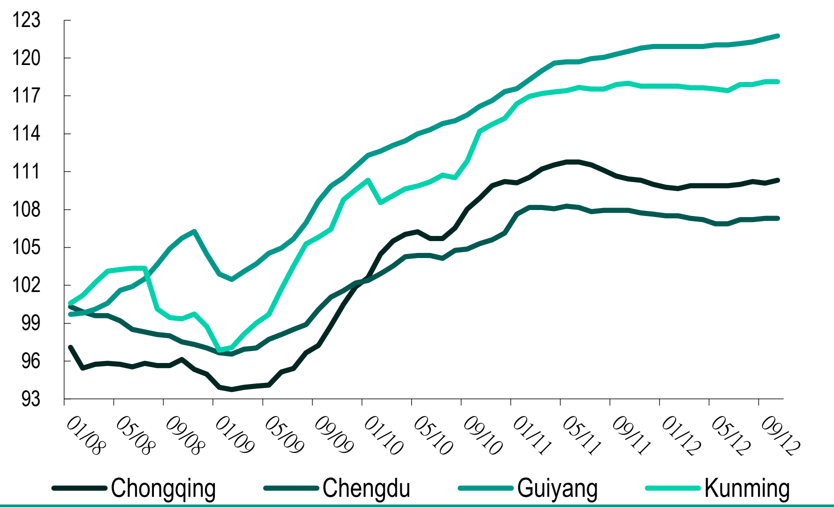
Note: Assuming 2007 housing price level equals 100
Source: National Bureau of Statistics of China

China property price index: tier-2 Cities



Note: Assuming 2007 housing price level equals 100
Source: National Bureau of Statistics of China

China property price index: tier-3 cities



Note: Assuming 2007 housing price level equals 100
Source: National Bureau of Statistics of China

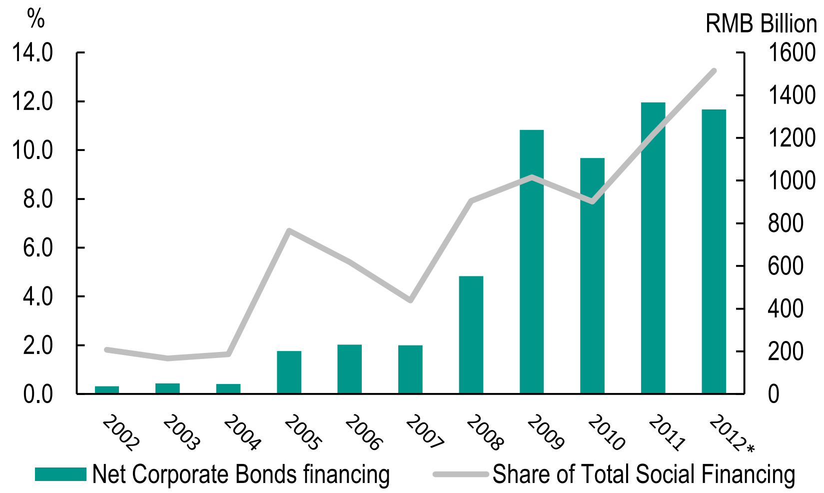
7. Financial reform as a top priority

China will speed up financial reforms, including interest rate liberalization, renminbi trading band, bond market reform, etc.

Reforming China's financial sector looks to be a top priority for China's new leadership as financial reforms are high on the central government's agenda. These reforms are essential in facilitating China's rebalancing away from an export-driven to consumption-focused economy. In 2012, the PBOC began the process of interest rate liberalization, giving lenders the flexibility to set interest rates for consumers. The reform allows market forces to play a greater role in capital allocation and will help shift the balance of the economy towards consumption as higher bank deposit rates would give households more spending power and higher lending rates would reduce excess investment.

In addition, new loans represent over 50% of total social financing in China, reflecting a heavy reliance on bank funding. China must shift its economy away from an overreliance on bank funding, and create other financing options for corporates. Expansion of China's bond market is critical for reducing the concentration of financial risk in the banking system and it is expected to be an important goal for policymakers in 2013. Policymakers have begun to speed up the development of the bond market, introducing pilot programs for municipal and high-yield bonds. In 2012, Beijing selected four local governments to begin issuing bonds in order to raise revenue. In June 2012, China began a program allowing smaller companies to sell high-yield bonds through private placements. Corporate bond issuance has also been on the rise. We expect the expansion of municipal and corporate bonds to double the size of the domestic bond markets in the coming five years

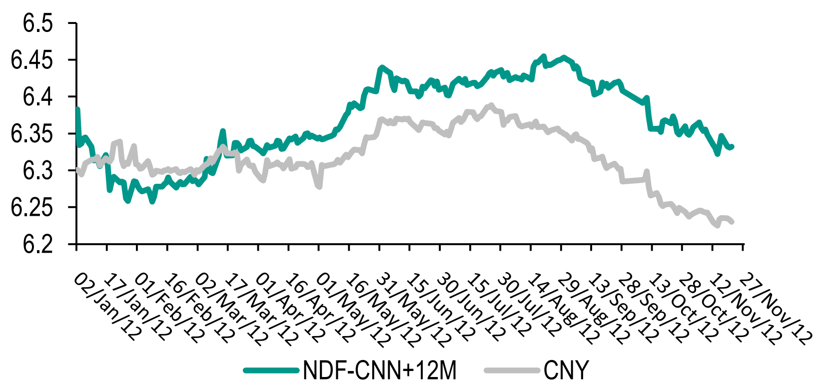
Net corporate bonds financing and share of total social financing



**forecast*
Source: Bloomberg, ABCIS estimates

Renminbi internationalization continues to be a major focus in 2013. There are more and more moves to full convertibility of the renminbi. The need for a fully convertible currency is building as the global use of the renminbi as a trade settlement currency is on the rise with which around 9% of global trade uses renminbi to settle. We expect China will further widen the trading band of reminbi to 2% and encourage the use of the renminbi as trade settlement currency in 2013.

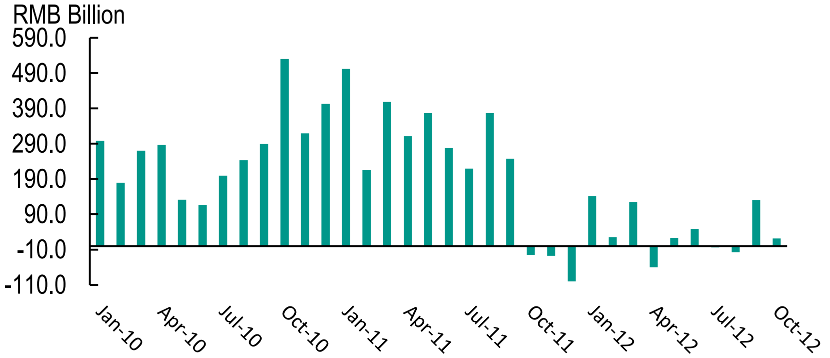
CNY and NDF-12 months



Source: Bloomberg

Liberalization of capital account is another focus of financial reforms in 2013. It will be a gradual process, as China needs to improve its ability to address risks such as hot money and asset bubbles. In recent years, China has made significant progress in capital account liberalization by gradually easing its grip on its currency and moving it towards full convert convertibility. China has also stepped up efforts to widen the scope of QDII scheme for overseas investment and to allow more QFII capital to invest in China's capital markets.

Position for forex purchase (RMB bn)



Source: Bloomberg

Faster loosening of the government's strict capital controls are of paramount importance in strengthening capital market development. We expect further relaxation of controls on investment directly related to trade and promotion of Chinese enterprises to increase overseas foreign direct investment. China aims at strengthening financial sector development by opening more channels for credits to flow in and out of China and moving from quantity-based to price-based approaches to monetary management. We believe China will step up its commitment to financial reforms in 2013 and the pace of reforms will quicken in the coming years, anticipating a swathe of reforms that will revolutionize China’s financial system.

Hong Kong economic outlook for 2013

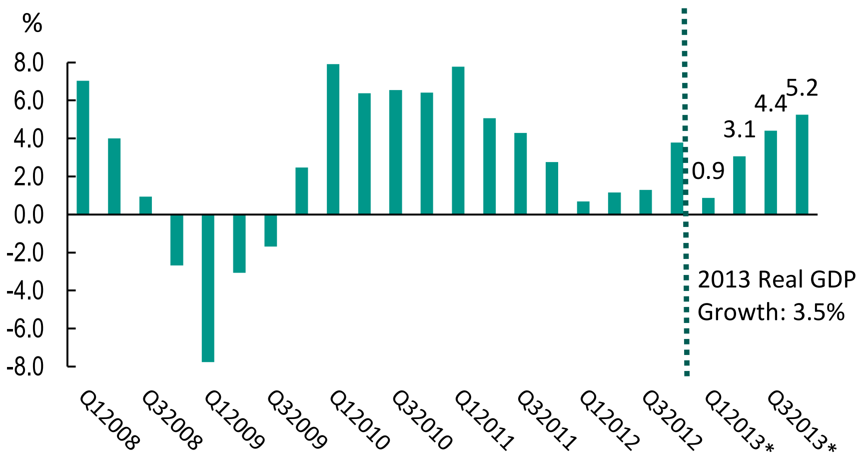
HK economic growth momentum pointed to the downside in 1H12 with GDP growth decelerating to 0.9% YoY amid external turmoil and weak domestic consumption. 3Q12 GDP growth at 1.3% YoY showed signs of stabilization given the bottomed-out of China's economic growth and continued recovery of the US economy. However, global economic activities still remain sluggish and we expect HK economy will only slightly improve in 2H12, with 2012 GDP growth reaching 1.8% YoY. Monetary easing of developed economies, stabilization of Europe debt crisis and acceleration of China's economic growth fine-tune our estimate for Hong Kong economic growth to 3.5% in 2013.

Economic forecasts for Hong Kong

Year	2010	2011	2012F	2013F
Real GDP	6.8	4.9	1.8	3.5
Consumption	6.3	8.2	3.6	3.8
Investment	7.4	7.5	8.6	5
Government Consumption	3.3	2.2	3.3	3.2
Exports	16.8	4.1	1.1	2.2
Imports	17.4	4.6	1.9	3.1
Unemployment Rate	4	3.4	3.5	3.4
Inflation	2.4	5.5	4.5	4.2

**forecast*
Source:Bloomberg, ABCIS estimates

HK's GDP growth forecast



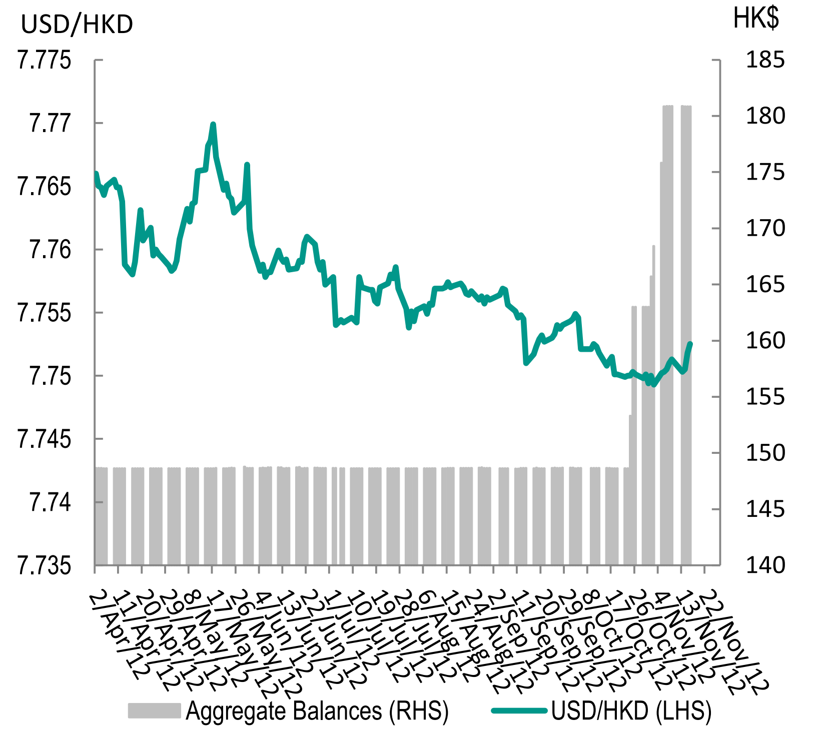
**forecast*
Source:Bloomberg, ABCIS estimates

Arrival of liquidity

Abundant liquidity sustains support to Hong Kong asset market in 2013

With the US Federal Reserve Bank engaging in QE3 as well as extending its low interest rate policy into 2015, HK interest rate environment will remain soft under currency board arrangement. Monetary easing in developed economies leads to fund flows to HK in search of higher investment returns. The HKMA was forced to intervene in the market to defend the dollar peg, resulting in an influx of liquidity into banking system. The medium-term impact of the intervention is the improvement in interbank liquidity. The easing monetary conditions sustain support to Hong Kong asset market in 2013, resulting in a boost to economic growth.

The beginning of Hong Kong's liquidity boom



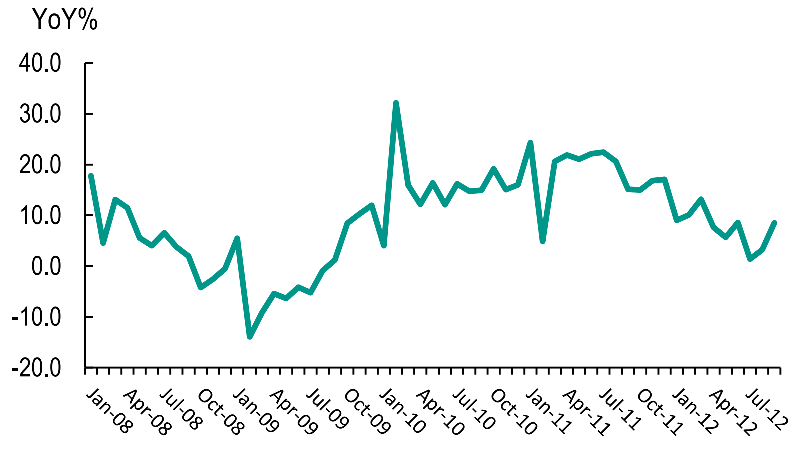
Source:Bloomberg

Recovery of consumption growth

Hong Kong consumption will restore stronger growth momentum in 2013 given China's economic recovery and appreciation of the renminbi

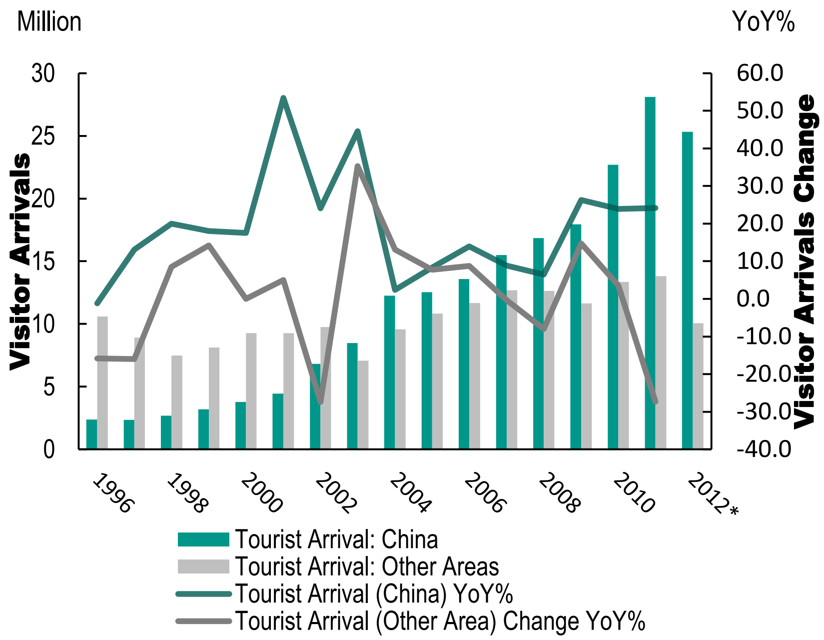
Private consumption expenditure posted a weak growth of 2.8% YoY in 3Q12 against 4.9% in 1H12. Private consumption in Hong Kong, largely underpinned by the flood of tourists especially from mainland China, has seen a decline in its contribution to GDP growth contribution for the four consecutive quarters since 2Q11. Amid the recovery of China's economic momentum in 4Q12 and appreciation of the renminbi, we expect Hong Kong retail sales will enjoy rebound in 4Q12 and 2013, which help boost the GDP growth.

Hong Kong retail sales becomes stabilized



Source:Hong Kong Census

Tourist arrival



**forecast*
Source:Hong Kong Census

Cooling the property market

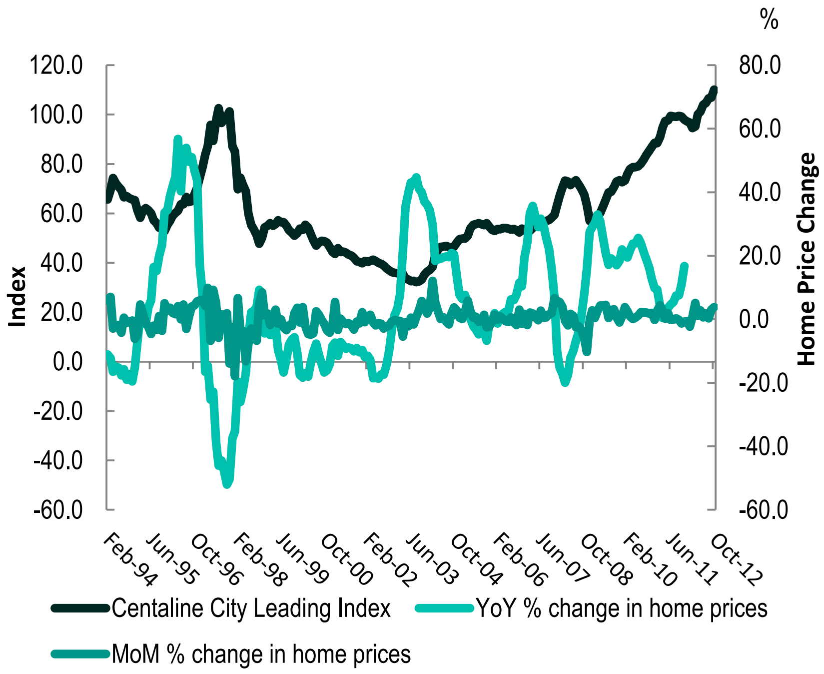
The Government's new tightening measures cool down the sentiment and lower transaction volumes, but the property prices is unlikely to have any significant correction

Aggressive measures expect to cool down sentiment but not property prices. Following the strong move of property prices up 18%, HK government announced a new round of aggressive measures targeting the demand segment, including a buyer's stamp duty at 15% on consideration for buyers not having HK permanent ID and the increase of the Special Stamp Duty (SSD) from a range of 5-15% to

10-20% and extend the restriction period liable for SSD from 2 years to 3 years.

Strong policy move aims at addressing the continual public noise of non-locals' investment demand that is believed to have driven up HK property prices. We expect the new measures will cool down the sentiment and lower transaction volumes, in particular the resale market but the property prices is unlikely to have any significant correction as the property market will continue to be fueled by low mortgage rates and high investment demand from local households. We believe the government policy will continue to focus on demand as local end-users are still driving the market.

Hong Kong property price continues to rise



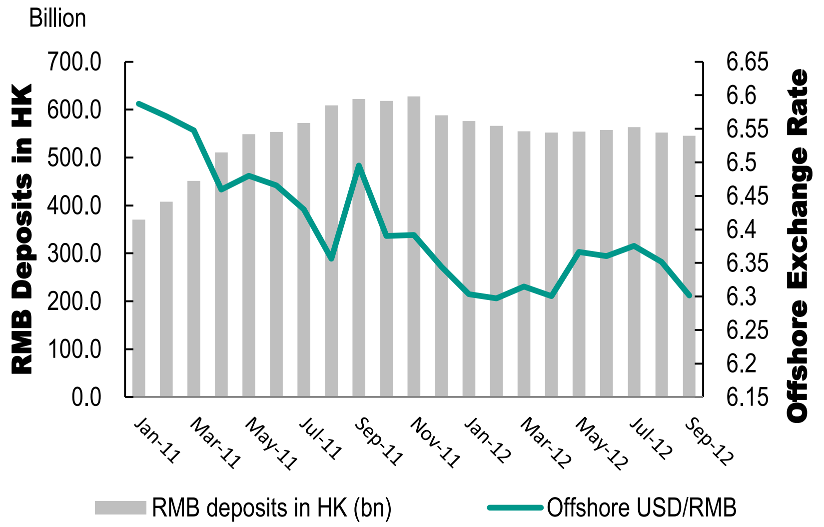
Source: CENTADATA

Hong Kong still the leading renminbi offshore center

Hong Kong still plays a key role as the leading center of offshore renminbi

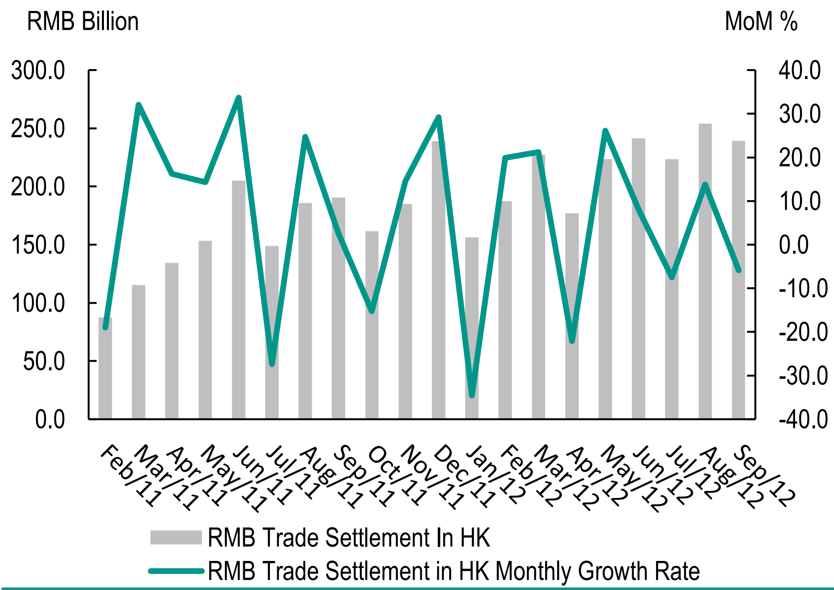
In 2004, Hong Kong became the first offshore market to launch renmibi deposit-taking business. Ever since, Hong Kong's renminbi business has been developing significantly in different dimensions, including currency exchange, remittance, credit and debit cards, cheques, trade settlement, dim sum bond issuance and trading, as well as renminbi denominated Initial Public Offering (IPO) and stock trading. While renminbi internationalization continues to proliferate in other financial markets, Hong Kong remains the premier offshore renminbi financial platform, possessing the largest pool of liquidity outside of mainland China. The current announcement of a nearly three-fold jump in RQFII quotas (from 70 bn to 270 bn) further strengthens Hong Kong as the premier offshore RMB financial center.

RMB deposits and offshore USD/RMB



Source:Bloomberg, HKMA

RMB trade settlement & monthly growth rate



Source:HKMA

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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 2007-2011
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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