農銀國際
ABC INTERNATIONAL
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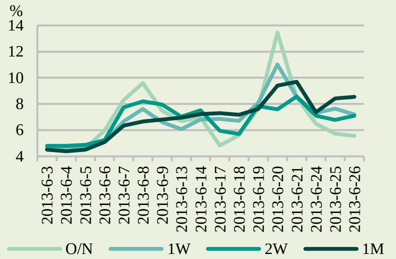
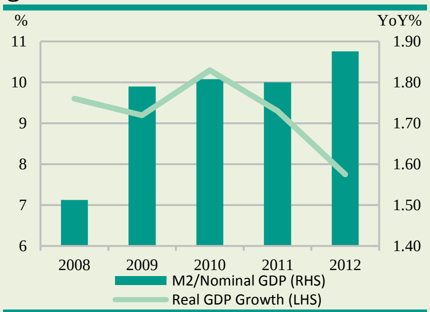
Ups and downs of SHIBOR in June



Source: shibor.org, ABCIS

Credit growth outpacing economic growth



Source: Bloomberg, ABCIS

Chief Economist

Banny Lam
Tel: 852-21478863
Email: bannylam@abci.com.hk

A new era of China's liquidity management

China's new leadership vowed to deepen the economic reforms to sustain economic growth. Premier Li Keqiang and his team aim at fixing the financial imbalances and sacrificing shorter-term growth for longer-term stability. The recent crunch in the interbank market is the most obvious evidence of the new stance. The credit crunch is a consequence of the PBOC refusing to jump in with extra liquidity, part of a move to tackle rampant credit growth and an increasingly unsustainable shadow banking system. China's SHIBOR turbulence turns out to be an intended policy of the PBOC to force banks to better manage liquidity.

- **Massive liquidity squeeze in June caused by several factors.** Several specific factors contributed to the credit tightness in June, including misunderstanding between the markets and the PBOC about the policy stance and implementation, corporate tax payments, strong liquidity demand around a national holiday, the impact of measures taken in May to clamp down on capital inflows and turbulence in international capital markets after the announcement of the US's QE exit timeline. The surge in the cost of short-term funds stemmed from an overstretched financial sector and a mismatch between banks' short-term funding needs and long-term loans were the structural factor leading to the abnormality of money market.

- **Misallocation of liquidity and expectation bias exaggerating the crunch.** In the past, banks got used to obtain additional liquidity from the PBOC through direct and indirect channels amid shortage of capital in the market. These induced them to engage in loose liquidity management and abnormal lending activities that post threat to the real economy. The PBOC's stance on doing little to ease the tightness is an indication that the government's priority is to restore proper allocation of capital in fulfilling an implicit target for credit growth and boosting the economic growth.

- **Paving the way for further interest rate liberalization.** It is becoming clear that China's new economic leadership team is willing to accept some short-term pain for long-term gains. In our view, China's liquidity crunch won't pose systemic risks to China's economy as the financial risks emanating from the non-bank financial system are not large and systemic enough to overwhelm macroeconomic and financial stability in China. As China moves to curb reckless credit growth and enhance transparency in order to tackle the structural problems in money market, it will need to discipline the market through not only a true threat, but also interest rate reform. A more market-oriented interest rate system will further optimize the credit structure to allow the financial sector to better serve the real economy. China will accelerate the pace of pushing forward market-oriented reform in interest rate system in 2H13.

China Economic Indicators

	2012								2013				
	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May
Real GDP (YoY%)	---	7.6	---	---	7.4	---	---	7.9	---	---	7.7	---	---
Export Growth (YoY%)	15.3	11.1	1	2.7	9.9	11.6	2.9	14.1	25.0	21.8	10.0	14.7	1
Import Growth (YoY%)	12.7	6.3	4.7	-2.6	2.4	2.4	0	6	28.8	-15.2	14.1	16.8	-0.3
Trade Balance (USD/Bn)	18.13	31.91	25.28	26.43	27.45	32.11	19.63	31.6	29.2	15.3	-0.9	18.2	20.4
Retail Sales Growth (YoY%)	13.8	13.7	13.1	13.2	14.2	14.5	14.9	15.2	12.3		12.6	12.8	12.9
Industrial Production (YoY%)	9.6	9.5	9.2	8.9	9.2	9.6	10.1	10.3	9.9		8.9	9.3	9.2
PMI - Manufacturing (%)	50.4	50.2	50.1	49.2	49.8	50.2	50.6	50.6	50.4	50.1	50.9	50.6	50.8
PMI - Non-manufacturing (%)	55.2	56.7	55.6	56.3	53.7	55.5	55.6	56.1	56.2	54.5	55.6	54.5	54.3
FAI(YTD) (YoY%)	20.1	20.4	20.4	20.2	20.5	20.7	20.7	20.6	21.2		20.9	20.6	20.4
CPI (YoY%)	3	2.2	1.8	2	1.9	1.7	2	2.4	2.0	3.2	2.1	2.4	2.1
PPI (YoY%)	-1.4	-2.1	-2.9	-3.5	-3.6	-2.8	-2.2	-1.9	-1.6	-1.6	-1.9	-2.6	-2.9
M2 (YoY%)	13.2	13.6	13.9	13.5	14.8	14.1	13.9	13.8	15.9	15.2	15.7	16.1	15.8
New Lending (RMB/Bn)	793.23	919.83	540.1	703.9	623.2	505.2	522.9	454.3	1070.0	620.0	1060.0	793	667.4

World Economic/Financial Indicators

Equity Index

	Closing price	Chng. WTD (%)	P/E
US			
DJIA	14910.14	0.75	14.52
S&P 500	1603.26	0.68	15.69
NASDAQ	3376.22	0.57	21.22
MSCI US	1528.38	0.71	15.97
Europe			
FTSE 100	6193.62	1.27	15.91
DAX	7952.20	2.09	15.12
CAC40	3724.68	1.82	15.57
IBEX 35	7784.10	1.09	78.06
FTSE MIB	15385.54	0.86	191.74
Stoxx 600	284.70	1.53	N/A
MSCI UK	1822.45	0.78	15.71
MSCI France	104.03	1.74	19.10
MSCI Germany	108.61	1.84	13.95
MSCI Italy	44.23	1.00	53.30
Asia			
NIKKEI 225	13213.55	-0.13	24.23
S&P/ASX 200	4811.28	1.53	19.49
HSI	20440.08	0.87	9.45
HSCEI	9158.61	-0.85	7.49
CSI300	2160.74	-6.76	10.72
SSE Composite	1950.01	-5.94	10.49
SZSE Composite	886.91	-5.56	25.81
MSCI China	53.06	-0.19	8.94
MSCI Hong Kong	10854.47	0.36	9.74
MSCI Japan	663.95	-2.71	21.47

Global Commodities

		Unit	Price	Chng. WTD (%)	Volume (5-day average)
Energy	NYMEX WTI	USD/bbl	95.81	2.26	248482.60
	ICE Brent	USD/bbl	102.09	1.17	239224.40
	NYMEX Natural Gas	USD/MMBtu	3.73	-0.98	82086.60
	Australia Newcastle Steam Coal Spot fob	USD/Metric Tonne	81.20	N/A	N/A
Basic Metals	LME Aluminum Cash	USD/MT	1725.75	-1.25	50952.20
	LME Primary Aluminum 3 Month Rolling Forward	USD/MT	1771.00	-1.23	48997.60
	CMX Copper Active Contract	USD/lb.	306.10	-1.11	77301.00
	LME Copper 3 Month Rolling Forward	USD/MT	6735.00	-1.22	60750.80
	TSI CFR China Iron Ore Fines Index	USD	113.80	-4.05	N/A
Precious Metals	CMX Gold	USD/T. oz	1308.40	-5.71	114458.80
	CMX Silver	USD/T. oz	20.28	-7.65	40805.40
	NYMEX Platinum	USD/T. oz	1399.10	-3.34	12933.20
Agricultural Products	CBOT Corn	USD/bu	665.00	0.49	79181.80
	CBOT Wheat	USD/bu	670.75	-3.90	43034.80
	NYB-ICE Sugar	USD/lb.	16.98	1.43	64044.00
	CBOT Soybeans	USD/bu.	1537.50	2.96	52994.00

Bond Yields & Key Interest Rates

	Yield (%)	Chng. WTD (%)
US Fed Fund Rate	0.25	0.00
US Prime Rate	3.25	0.00
US Discount Window	0.75	0.00
US Tresury (1 Month)	0.0101	0.00
US Tresury (10 Yr)	2.5205	-0.41
US Tresury (30 Yr)	3.5698	-0.34
Japan 10-Yr Government Bond	0.838	-4.34
China 10-Yr Government Bond	3.61	4.34
ECB Interest Rate (Refinancing)	0.5	0.00
1-Month LIBOR	0.1954	1.22
3 Month LIBOR	0.2756	1.04
3-Month SHIBOR	5.539	-4.34
3-Month HIBOR	0.3821	-0.37
Corporate Bonds (Moody's Seasoned)		
Aaa	4.46	0.68
Baa	5.48	1.67

Currency

	Euro/USD	GBP/USD	AUD/USD	USD/JPY	USD/CHF	USD/CAD	USD/CNY	USD/HKD	USD/ CNY NDF 12 Month
Spot Exchange Rate	1.3034	1.5292	0.9315	98.1700	0.9433	1.0436	6.1489	7.7572	6.3040
Chng. WTD (%)	-0.67	-0.82	1.04	-0.28	-0.93	0.20	-0.26	0.01	-0.11

Note:
1. *Data source: Bloomberg Finance LP, National Bureau of Statistics of China, ABCIS*
2. *Australia Newcastle Steam Coal Spot fob is the Australia Newcastle 6700 kc GAD fob Steam Coal Spot price published by McCloskey*
3. *TSI CFR China Iron Ore Fines Index is calculated with the 62% Fe specification, spot price*
4. *Data is updated on the date of this report*

Disclosures

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Definition of equity rating

ting	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.

Disclaimer

Office address: ABCI Securities Company Limited, 13/F Fairmont House, 8 Cotton Tree Drive, Central, Hong Kong. Tel: (852) 2868 2183