



## Economics Weekly

### Exhibit 1:

#### Recent financial reform measures

Date	Event
20-Jun-13	Overnight SHIBOR rate surged to 13.44%, yet government did little to intervene.
23-Jun-13	PBOC's monetary policy committee announced that interest rate liberalization was one of the priorities on its reform agenda.
3-Jul-13	State Council approved plans to set up a free trade zone in Shanghai.
8-Jul-13	CSRC announced that it was working towards the inclusion of A-shares in the global MSCI emerging markets index
12-Jul-13	CSRC announced expansion of QFII quota to US\$ 150bn
20-Jul-13	The lending rate floor was removed

Source(s): Bloomberg, CSRC, PBOC, PRC Government, SHIBOR.Org.

### Exhibit 2:

#### Current lending rates vs. bond yields

Maturity	Average yield of bonds issued by HSI Chinese constituents (%)	PBOC benchmark lending rate with 30% discount (%)
1 Yr	3.3779	4.200
1-3 Yr	3.9360	4.305
4-5 Yr	3.8582	4.480

Source(s): Bloomberg, PBOC, ABCI Securities

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## Prelude to future financial reforms

The PBOC announced the removal of lending rate floor on July 20, making another move to liberalize the interest rate in China. Theoretically, such a move will provide Chinese banks with more freedom to set lending rates by themselves and allow corporations to obtain bank loans at lower rates. Although the change is not as significant as removing the cap on deposit rate and its immediate impacts may not be as apparent, removing the interest rate floor signals the central government's determination to reform the financial sector and revitalize the economy. China's new leadership will continue to prioritize reforms in the financial sector by rolling out policies such as removing the deposit rate ceiling and liberalizing the exchange rate regime as early as 2H13.

- **Smooth transition with minimal immediate impact.** As an important step towards a market-oriented financial system, the removal of lending rate floor is intended to release more funding from banks to the corporate sector, creating incentives for corporations to improve their credit qualities for lower borrowing rates, and enhance capital allocation to the corporate sector. Yet, we are cautious about effectiveness of such policy in the near term as the recent credit squeeze demonstrates that the tight liquidity situation has not yet subsided and the overall liquidity condition still deters immediate reduction of lending rates. The new policy allows banks to compete for corporate borrowers with good credit profile at better pricing terms, enhancing price competition between banks and non-bank financial institutions.
- **Beginning of a new era for Chinese banks.** The removal of lending rate floor has been well-timed by the PBOC to ensure banks could experience a smoother transition during the financial reform without any substantial drops in net interest margin (NIM) under the tight liquidity condition. In the long run, however, the NIM of China banks will shrink amid the full liberalization of interest rates. Banks will be driven to increase competitiveness by attracting deposits and loans from companies with higher credit qualities. They would need to devise ways to dissuade companies from issuing bonds with lower lending rates, which will inevitably result in direct competition between the bank loan issuers and bond underwriters (see Exhibit 2). Banks should also enhance their capability to structure fee-income business to obtain higher yields. The diversification of commercial banks' business portfolio will help build a healthier financial system.
- **More financial reforms to come.** The removal of lending rate floor indicates the new leadership's uncompromising stance on economic reform. Reform in deposit rate could be announced as early as 2H13. The internationalization of Renminbi, which will be accelerated by developing free trade zones in major metropolitan areas and encouraging the issuance of "Dim Sum bond" in pilot areas (such as Qianhai), is also one of the government's priorities. Further expansion of programs enabling cross-border capital flow will also be implemented, as suggested by the recent approval of an additional quota of US\$ 150bn for QFII programs, the announcement of the RQFII pilot scheme in London and Singapore, and the possible approval of the second round of QDII to be launched in Guangzhou and Shenzhen. In short, a series of financial reforms will be highly anticipated in the following months.



China Economic Indicators

	2012							2013					
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Real GDP (YoY%)	7.6	---	---	7.4	---	---	7.9	---	---	7.7	---	---	7.5
Export Growth (YoY%)	11.1	1	2.7	9.9	11.6	2.9	14.1	25.0	21.8	10.0	14.7	1.0	(3.1)
Import Growth (YoY%)	6.3	4.7	(2.6)	2.4	2.4	0	6	28.8	(15.2)	14.1	16.8	(0.3)	(0.7)
Trade Balance (USD/bn)	31.91	25.28	26.43	27.45	32.11	19.63	31.6	29.2	15.3	(0.9)	18.2	20.4	27.1
Retail Sales Growth (YoY%)	13.7	13.1	13.2	14.2	14.5	14.9	15.2	12.3	12.6	12.8	12.9	13.3	
Industrial Production (YoY%)	9.5	9.2	8.9	9.2	9.6	10.1	10.3	9.9	8.9	9.3	9.2	8.9	
PMI - Manufacturing (%)	50.2	50.1	49.2	49.8	50.2	50.6	50.6	50.4	50.1	50.9	50.6	50.8	50.1
PMI - Non-manufacturing (%)	56.7	55.6	56.3	53.7	55.5	55.6	56.1	56.2	54.5	55.6	54.5	54.3	53.9
FAI(YTD) (YoY%)	20.4	20.4	20.2	20.5	20.7	20.7	20.6	21.2	20.9	20.6	20.4	20.1	
CPI (YoY%)	2.2	1.8	2	1.9	1.7	2	2.4	2.0	3.2	2.1	2.4	2.1	2.7
PPI (YoY%)	(2.1)	(2.9)	(3.5)	(3.6)	(2.8)	(2.2)	(1.9)	(1.6)	(1.6)	(1.9)	(2.6)	(2.9)	(2.7)
M2 (YoY%)	13.6	13.9	13.5	14.8	14.1	13.9	13.8	15.9	15.2	15.7	16.1	15.8	14.0
New Lending (RMB/bn)	919.83	540.1	703.9	623.2	505.2	522.9	454.3	1070.0	620.0	1060.0	792.9	667.4	860.5

World Economic/Financial Indicators

Equity Indices				Global Commodities				Bond Yields & Key Interest Rates					
	Closing price	Chg. WTD (%)	P/E		Unit	Price	Chg. WTD (%)	Volume (5-day average)		Yield (%)	Chg. WTD (%)		
<b>US</b>				<b>Energy</b>	NYMEX WTI	USD/bbl	108.44	0.36	198,570.40	US Fed Fund Rate	0.25	0.00	
DJIA	15543.74	0.00	15.01		ICE Brent	USD/bbl	108.24	0.16	142,605.20	US Prime Rate	3.25	0.00	
S&P 500	1692.09	0.00	16.31		NYMEX Natural Gas	USD/MM Btu	3.74	(1.24)	119,871.80	US Discount Window	0.75	0.00	
NASDAQ	3587.62	0.00	22.91		Australia Newcastle Steam Coal Spot fob	USD/Metric Tonne	76.40	N/A	N/A	US Treasury (1 Mth)	0.0355	596.08	
MSCI US	1614.16	0.00	16.59		LME Aluminum Cash	USD/MT	1,781.50	0.00	50,105.40	US Treasury (10 Yr)	2.4729	(0.44)	
<b>Europe</b>				<b>Basic Metals</b>	LME Primary Aluminum 3 Month Rolling Forward	USD/MT	1,825.00	0.00	29,972.80	US Treasury (30 Yr)	3.5455	(0.42)	
FTSE 100	6638.61	0.12	17.08		CMX Copper Active Contract	USD/lb.	315.00	0.00	341.00	Japan 10-Yr Government Bond	0.7880	(3.19)	
DAX	8354.67	0.28	15.76		LME Copper 3 Month Rolling Forward	USD/MT	6,915.00	0.00	50,016.80	China 10-Yr Government Bond	3.6800	0.00	
CAC40	3937.08	0.30	16.42		TSI CFR China Iron Ore Fines Index	USD	131.70	3.86	N/A	ECB Interest Rate (Refinancing)	0.50	0.00	
IBEX 35	7989.70	0.59	88.81		CBOT Corn	USD/bu	498.50	(0.45)	110,436.60	1-Month LIBOR	0.1910	(0.47)	
FTSE MIB	16238.98	0.71	202.38	CBOT Wheat	USD/bu	667.00	0.38	38,365.00	3 Month LIBOR	0.2647	(1.08)		
Stoxx 600	300.50	0.22	N/A	NYB-ICE Sugar	USD/lb.	16.46	1.04	46,721.40	3-Month SHIBOR	4.6515	(0.02)		
MSCI UK	1960.57	0.00	16.90	CBOT Soybeans	USD/bu.	1,272.50	(0.12)	81,176.00	3-Month HIBOR	0.3829	0.00		
MSCI France	109.57	0.00	20.11							Corporate Bonds (Moody's Seasoned)			
MSCI Germany	114.02	0.00	14.60							Aaa 4.35 0.00			
MSCI Italy	46.17	0.00	55.64							Baa 5.31 (1.30)			
<b>Asia</b>				<b>Precious Metals</b>	CMX Gold	USD/T. oz	1,314.80	1.69	145,161.00				
NIKKEI 225	14658.04	0.47	27.05		CMX Silver	USD/T. oz	19.88	2.13	34,242.60				
S&P/ASX 200	5001.86	0.60	20.38		NYMEX Platinum	USD/T. oz	1,434.50	0.23	6,555.20				
HSI	21416.50	0.25	9.90	<b>Agricultural Products</b>								<i>Note:</i>	
HSCEI	9415.06	(0.35)	7.70									1. Data sources: Bloomberg Finance LP, National Bureau of Statistics of China, ABCIS	
CSI300	2202.19	0.53	10.96									2. Australia Newcastle Steam Coal Spot fob is the Australia Newcastle 6700 kc GAD fob Steam Coal Spot price published by McCloskey	
SSE Composite	2004.76	0.61	10.80								3. TSI CFR China Iron Ore Fines Index is calculated with the 62% Fe specification, spot price		
SZSE Composite	948.27	1.78	27.66								4. Data is updated on the date of the report		
MSCI China	55.52	0.00	9.36										
MSCI Hong Kong	11187.38	0.00	10.03										
MSCI Japan	753.18	0.00	24.88										
<b>Currency</b>													
										USD/CNY			
Euro/USD GBP/USD AUD/USD USD/JPY USD/CHF USD/CAD USD/CNY USD/HKD										NDF 12 Month			
Spot Exchange Rate	1.32	1.53	0.92	100.01	0.94	1.04	6.14	7.76	6.28				
Chg. WTD (%)	0.14	0.14	0.23	0.64	0.16	0.14	(0.05)	0.00	0.01				



**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 2007-2011  
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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