



Economic Insight

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China's economic growth will moderate in 2H18/2019

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- Based on the latest data, China's economy has started the second quarter at a moderate pace due to ongoing deleveraging, financial risk prevention, rising financing costs, and tightening financial regulatory measures
- Production and external demand remained strong in April and May, supporting short-term economic growth. Domestic demand fell sharply over the same period, however. Growth in fixed asset investment and retail sales in April and May were significantly below 1Q and market expectations
- Looking ahead, despite strong 1Q figures, we believe China's economic growth will moderate slightly in coming quarters as uncertainty escalates. With intensifying Sino-US friction, rising cost of real estate financing, and slowing infrastructure investment growth, we maintain our 6.6% and 6.4% GDP growth forecasts for China in 2018E and 2019E
- We expect PBOC to keep the benchmark interest rates steady in 2018 and 2019. Targeted RRR would be slashed twice in 2H18 and thrice in 2019 given the mild inflationary pressure and moderating economic momentum

Waning momentum in China

Based on the latest data, China's economy has started the second quarter at moderate pace due to ongoing deleveraging, financial risk prevention, rising financing costs, and tightening financial regulatory measures. Although production and external demand remained strong in April and May, supporting short-term economic growth, domestic demand fell sharply over the same period. Fixed asset investment (FAI) and retail sales growth in April and May were significantly below 1Q and market expectations.

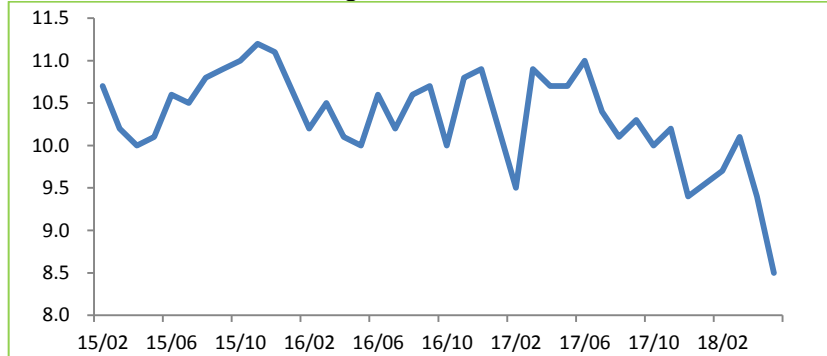
Thanks to high PPI, industrial production rose 7.0%¹ in April and 6.8% in May after growing by 6.8% in 1Q. Electricity output expanded 6.9% in April and 9.8% in May, compared with the 8.0% increase in 1Q. PMI for manufacturing, which covers 31 industries, quickened to 51.4 in April and 51.9 in May from the average 51.0 in 1Q. Meanwhile, the profit growth of industrial enterprises accelerated to 21.9% and 21.1% in April and May from 11.6% in 1Q.

Internal demand lost steam, as evidenced by slackened growth in both consumer spending and FAI. Retail sales growth decelerated to 9.4% in April and 8.5% in May from 9.8% in 1Q, mainly attributable to consumption being squeezed by a surge in residential home loans and delayed by lower tariffs on some consumer goods due to take effect in 2H (Exhibit 1). FAI growth in urban areas also retracted to 6.1% in April and 3.9% in May from 7.5% in 1Q, which we believe to be a result of slowdown in infrastructure investment amid tightening fiscal spending (Exhibit 2). Real estate and manufacturing investment grew at a solid pace in April and May, supported by strong sales in the property market and faster profit growth of industrial enterprises.

¹ All growth rates are year-on-year except specified otherwise

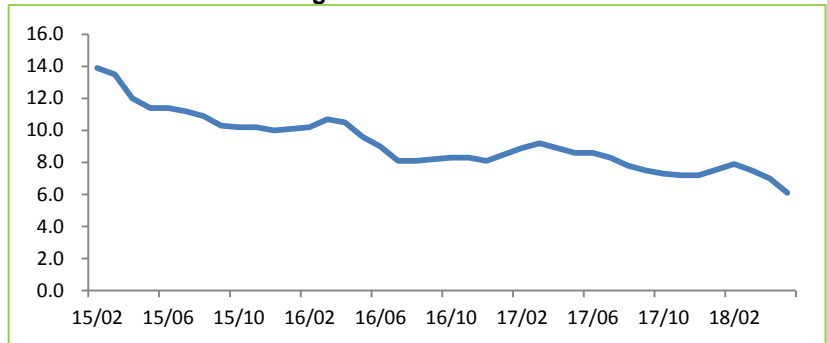


Exhibit 1: China's retail sales growth



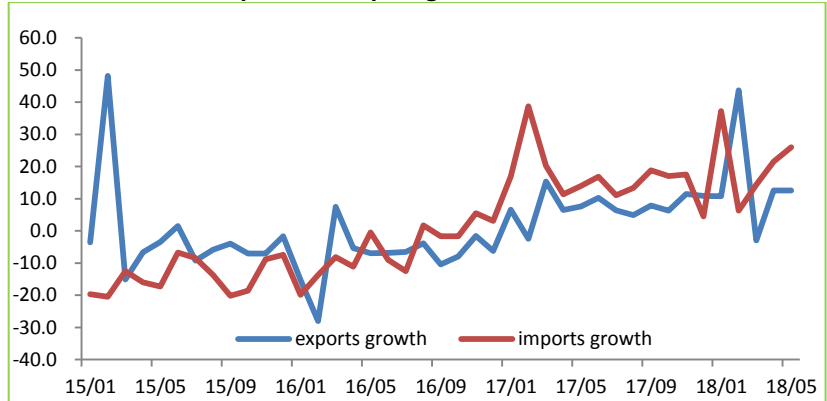
Source(s): NBS, ABCI Securities

Exhibit 2: China's FAI YTD growth



Source(s): NBS, ABCI Securities

Exhibit 3: China's export and import growth



Source(s): General Administration of Customs, ABCI Securities

On the external front, both export and import growth stayed buoyant in April and May (Exhibit 3). Export growth was 12.9% in April and 12.6% in May in USD terms, slightly lower than 14.1% in 1Q. Imports accelerated in April and May, rising by 21.5% and 26.0%, compared with 18.9% in 1Q. With the significant increase in import growth, trade balance remained low in April and May at US\$ 28.8bn and US\$ 24.9bn.

Inflation moderated in April and May. CPI fell to 1.8% in April and May from 2.1% in 1Q as food prices were down. Meanwhile, PPI remained high at 3.4% in April and 4.1% in May, similar to 3.7% in 1Q on the strong commodity prices, particularly those of oil and ferrous metal-related products.



On the monetary front, although PBOC lowered targeted RRR for some financial institutions by 1ppt on April 25 and replaced some of medium-term lending facilities, credit conditions continued to be tight in April and May amid deleveraging, financial risk prevention, and more stringent financial regulations. Growth in broad money supply (M2) was sluggish at 8.3% in April and May, while total social financing, a comprehensive measure of all types of financing for the real economy, fell to RMB 1,560bn in April and RMB 760bn in May from the average of RMB 1,850bn in 1Q.

Economic growth to moderate slightly in 2H18/2019

Despite strong 1Q GDP figures, we believe China's economic growth will moderate slightly in the coming quarters for the following reasons, but uncertainty is on the rise.

First, the resurgence of Sino-US trade dispute is likely to suppress export growth. After several rounds of negotiations, the US President announced a 25% tariff on about US\$ 50bn of imports from China while threatening to implement a 10% tariff on another US\$ 200bn of Chinese goods. If these tariffs are executed, China's merchandise exports to the US would be reduced by ~US\$ 32.5bn per year, which could reduce export growth by 14.4% annually. This calculation is based on the assumption that commodity price elasticity of Chinese exports to the US is neutral with a price elasticity coefficient of 1.

Second, ongoing deleveraging and tightening financial regulatory measures will continue to exert upward pressure on the interbank interest rates, driving up the lending interest rates. According to the 1Q18 Monetary Policy Report by PBOC, the weighted average lending rate rose to 5.96% in March 2018, compared with 5.74% in December 2017. Meanwhile, with CBRC issuing a series of regulations and the recent occurrence of bond credit defaults, the bond financing is likely to remain constrained.

Third, property financing cost is rising on further tightening measures. Developers encounter increasing difficulties in obtaining loans from commercial banks; also, interest rates on domestic and foreign debt issuance showed a marked increase. These factors will drag down property investment growth. In addition, budget deficit rate reduction, Public-private partnerships (PPP) project clean-up, and tightened grip on local government investment and financial regulation have hindered growth in infrastructure investment.

With escalating Sino-US tension, rising cost of real estate financing and stumbling growth observed in infrastructure investment, we maintain our 6.6% and 6.4% growth forecasts for the Chinese economy in 2018E and 2019E.

On the monetary front, PBOC is expected to maintain a neutral monetary policy with a loosening bias to balance among goals to lower leverage ratio, prevent financial risks, and maintain a steady growth. The Monetary Policy Committee of PBOC said during the 2Q18 regular meeting that "liquidity should be kept reasonably abundant", as opposed to the previous assertion in 1Q18 that "liquidity should be kept reasonably stable". Meanwhile, we expect PBOC to keep the benchmark interest rates steady in 2018 and 2019. Targeted RRR would be slashed twice in 2H18 and thrice in 2019



given the mild inflationary pressure and increasing economic slowdown. Regarding the exchange rate, we expect spot USD/CNY rate to approach 6.8500 at end-2018E and 6.9000 at end-2019E with the rising US interest rates.

Exhibit 4: Economic forecasts

Economic indicators	2017	2018E	2019E
Real GDP growth, %	6.9	6.6	6.4
FAI growth, %	7.2	6.0	5.5
Retail Sales growth, %	10.2	10.0	10.0
Export growth in USD terms, %	7.9	8.0	5.0
Import growth in USD terms, %	15.9	15.0	12.0
Industrial Production growth, %	6.6	6.5	6.2
CPI, %	1.6	2.0	2.0
PPI, %	6.3	3.5	2.5
M2 growth, %	8.2	8.5	8.5
New Aggregate Financing, RMB bn	19,445	20,000	20,000
New Yuan Loans, RMB bn	13,523	14,500	15,500
Spot CNY per USD, End-year	6.5068	6.8500	6.9000

Source(s): NBS, PBOC, ABCI Securities estimates



China Economic Indicators

	2017									2018				
	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May
Real GDP (YoY %)	---	---	6.9	---	---	6.8	---	---	6.8	---	---	6.8	---	---
Export Growth (USD, YoY %)	8.0	8.7	11.3	7.2	5.5	8.1	6.9	12.3	10.9	11.1	44.5	-2.7	12.9	12.6
Import Growth (USD, YoY %)	11.9	14.8	17.2	11.0	13.3	18.7	17.2	17.7	4.5	36.9	6.3	14.4	21.5	26.0
Trade Balance (USD bn)	38.0	40.8	42.8	46.7	42.0	28.5	38.2	40.2	54.7	20.3	33.7	-5.0	28.8	24.9
Retail Sales Growth (YoY %)	10.7	10.7	11.0	10.4	10.1	10.3	10.0	10.2	9.4	9.7	9.7	10.1	9.4	8.5
Industrial Production (YoY %)	6.5	6.5	7.6	6.4	6.0	6.6	6.2	6.1	6.2	7.2	7.2	6.0	7.0	6.8
PMI - Manufacturing (%)	51.2	51.2	51.7	51.4	51.7	52.4	51.6	51.8	51.6	51.3	50.3	51.5	51.4	51.9
PMI - Non-manufacturing (%)	54.0	54.5	54.9	54.5	53.4	55.4	54.3	54.8	55.0	55.3	54.4	54.6	54.8	54.9
FAI (YTD) (YoY %)	8.9	8.6	8.6	8.3	7.8	7.5	7.3	7.2	7.2	7.9	7.9	7.5	7.0	6.1
CPI (YoY %)	1.2	1.5	1.5	1.4	1.8	1.6	1.9	1.7	1.8	1.5	2.9	2.1	1.8	1.8
PPI (YoY %)	6.4	5.5	5.5	5.5	6.3	6.9	6.9	5.8	4.9	4.3	3.7	3.1	3.4	4.1
M2 (YoY %)	10.5	9.6	9.4	9.2	8.9	9.2	8.8	9.1	8.2	8.6	8.8	8.2	8.3	8.3
New Lending (RMB bn)	1100	1110	1540	826	1090	1270	663	1120	584	2900	839	1120	1180	1150
Aggregate Financing (RMB bn)	1390	1060	1780	1220	1480	1820	1040	1600	1140	3060	1170	1330	1560	761

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			
DJIA	24,216.05	(1.48)	18.07	NYMEX WTI	USD/bbl.	73.37	6.71	855,068	2.00	0.00	
S&P 500	2,716.31	(1.40)	20.71	ICE Brent Oil	USD/bbl	77.65	2.78	250,330	5.00	0.00	
NASDAQ	7,503.68	(2.46)	23.14	NYMEX Natural Gas	USD/MMBtu	2.94	(0.31)	71,439	US Discount Window	2.50	0.00
MSCI US	2,591.69	(1.45)	21.14	China Qinhuangdao Port Thermal Coal ²	USD/Metric Tonne	61.80	N/A	N/A	US Treasury (1 Yr)	1.7411	(7.85)
Europe				Basic Metals				US Treasury (5Yr)			
FTSE 100	7,615.63	(0.87)	13.62	LME Aluminum Cash	USD/MT	2,170.50	(0.41)	10,156	US Treasury (10 Yr)	2.8401	(4.39)
DAX	12,177.23	(3.20)	13.56	LME Aluminum 3 -mth. Rolling Fwd.	USD/MT	2,155.00	(0.92)	30,717	Japan 10-Yr Gov. Bond	0.0380	0.30
CAC40	5,275.64	(2.07)	16.62	CMX Copper Active	USD/lb.	6,640.50	(2.32)	10,596	China 10-Yr Gov. Bond	3.5370	(4.90)
IBEX 35	9,589.00	(2.07)	13.68	LME Copper 3- mth Rolling Fwd.	USD/MT	6,623.00	(2.45)	41,479	ECB Rate (Refinancing)	0.00	0.00
FTSE MIB	21,432.34	(2.08)	11.82	Precious Metals				1-Month LIBOR			
Stoxx 600	376.87	(2.11)	15.87	CMX Gold	USD/T. oz	1,250.30	(1.61)	226,451	3 Month LIBOR	2.3344	(0.45)
MSCI UK	2,200.38	(0.78)	13.69	CMX Silver	USD/T. oz	16.09	(2.71)	55,905	O/N SHIBOR	2.6280	4.20
MSCI France	152.77	(1.83)	16.84	NYMEX Platinum	USD/T. oz	849.00	(2.97)	20,332	1-mth SHIBOR	4.0310	(12.0)
Asia				Agricultural Products				3-mth HIBOR			
NIKKEI 225	22,194.21	(1.43)	17.01	CBOT Corn	USD/bu	367.00	(2.91)	156,339	Corporate Bonds (Moody's)		
S&P/ASX 200	6,216.00	(0.15)	18.39	CBOT Wheat	USD/bu	485.25	(3.77)	66,363	Aaa	3.93	(6.00)
HSI	28,497.32	(1.81)	11.40	NYB-ICE Sugar	USD/lb.	12.25	(1.29)	69,494	Baa	4.81	(6.00)
HSCEI	10,868.45	(2.87)	8.39	CBOT Soybeans	USD/bu.	885.00	(3.41)	104,954			
CSI300	3,423.53	(3.85)	13.00								
SSE Composite	2,786.90	(2.58)	13.56								
SZSE Composite	1,582.72	(0.92)	25.66								
MSCI China	85.52	(5.66)	14.42								
MSCI Hong Kong	15,265.41	(1.89)	10.34								
MSCI Japan	1,023.00	(0.99)	13.88								

Note:

1. Data sources: Bloomberg, National Bureau of Statistics of China, ABCIS (updated on date of report)
2. The price is Coal 5500 kcal/kg FOB Spot Price

Currency

	Euro/USD	GBP/USD	AUD/USD	USD/JPY	USD/CHF	USD/CNY	USD/HKD	USD/CNY NDF 12-mth Spot pr.
Spot Rate	1.1633	1.3104	0.7375	110.72	0.9950	6.6307	7.8473	6.7445
Chg. WTD (%)	(0.15)	(1.18)	(0.87)	(0.68)	(0.69)	(1.89)	(0.01)	(1.80)



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Definition of equity rating

Rating	Definition
Buy	Stock return rate \geq Market return rate (10%)
Hold	- Market return rate (-10%) \leq Stock return rate $<$ Market return rate (+10%)
Sell	Stock return $<$ - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months

Market return rate: average market return rate since 2005 (HSI total return index 2005-17 CAGR at 10%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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