



# Economics Weekly February 11, 2015

### Co-head of Research

Banny Lam

Tel: 852-21478863

Email: bannylam@abci.com.hk

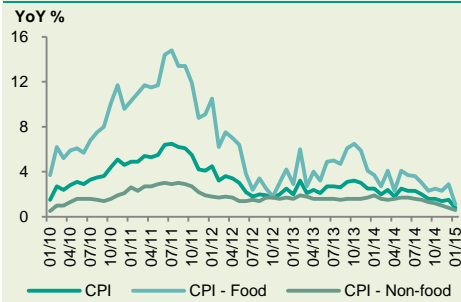
### Analyst

Paul Pan

Tel: 852-21478829

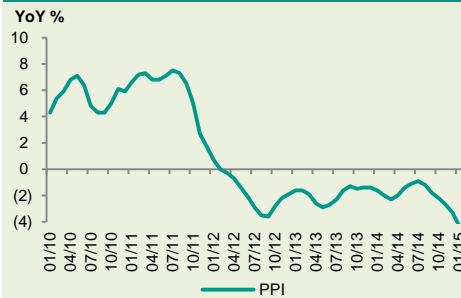
Email: paulpan@abci.com.hk

Exhibit 1: CPI inflation (food and non-food)



Source(s): Bloomberg, ABCI Securities

Exhibit 2: The decline of PPI widens



Source(s): Bloomberg, ABCI Securities

## Disinflation risk heightens in China

China's January CPI hits a 5-year low to 0.8% YoY mainly on easing food CPI and distortions caused by the Spring Festival (January in 2014 and February in 2015). The decline of PPI extended to a record 35 months and widened to 4.3% YoY, reflecting the global economic slowdown and price deflation in major international commodities and energy products. In view of surging deflationary risk in China, we expect more monetary loosening measures to stabilize inflation in coming months. Moreover, we believe the government will set the inflation target at 2.5% YoY for 2015F, a downward adjustment compared to 3.5% in 2014.

**Food prices become the major downside risk to inflation.** CPI fell from 1.5% YoY in December to 0.8% YoY in January. Food prices moderated to 1.1% YoY from 2.9% YoY in December and was the major drag on overall inflation. Pork price dropped 5.3% YoY, reflecting high inventory level, while vegetables prices declined 0.6% as supply was sufficient on stable weather conditions in January. Non-food CPI moderated to 0.6% YoY from 0.8% YoY in December mainly due to substantial drop in fuel prices. We expect inflation to undergo a seasonal rebound in February on surging price pressure during the Spring Festival.

**Worsening PPI deflation raises concerns over industrial sector outlook.** China's PPI dipped further, falling by 4.3% YoY in January compared to 3.3% YoY in December. The extended price decline for the 35<sup>th</sup> consecutive month was mainly driven by weakening prices of oil and other commodities as well as factory overcapacity. The latest PPI data indicate the deflationary risk has deepened. The outlook of industrial sector turns gloomy, as the slowing economic activities further suppress domestic demand, perpetuating the price deflation and slashing profits of industrial enterprises. Wholesale price deflation calls for further policy easing to revive the growth momentum of industrial sector.

**Risk of deflation is surging.** Drastic fall in global oil prices caused central bankers around the world to conduct credit loosening to defuse the deflationary pressure and bolster their economies. Aside from an uncertain global outlook and falling commodity prices, the risk of deflation is also ascending in China with the continuous downturn in the property market and widespread overcapacity in the industrial sector. The abating economic momentum calls for a lower interest rate to lessen financing burden and support economic reforms. Given the moderating trend of inflation and the mounting pressure to expand liquidity, we expect PBOC to assume an accommodative approach to pursue more stimulus measures and to inject more liquidity into the economy through a mix of targeting easing facilities and traditional monetary tools, such as interest rate and RRR cuts, in coming months.



China Economic Indicators

	2013		2014												2015
	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan*
Real GDP (YoY%)	---	7.7	---	---	7.4	---	---	7.5	---	---	7.3	---	---	7.3	---
Export Growth (YoY%)	12.7	5.8	10.6	(18.1)	(6.6)	0.9	7.0	7.2	14.5	9.4	15.3	11.6	4.7	9.7	(3.3)
Import Growth (YoY%)	5.3	6.5	10.0	10.1	(11.3)	0.8	(1.6)	5.5	(1.6)	(2.4)	7.0	4.6	(6.7)	(2.4)	(19.9)
Trade Balance (USD/bn)	33.8	32.3	31.9	(23.0)	7.7	18.5	35.9	31.6	47.3	49.8	30.9	45.4	54.5	49.6	60.0
Retail Sales Growth (YoY%)	13.7	13.6		11.8	12.2	11.9	12.5	12.4	12.2	11.9	11.6	11.5	11.7	11.9	N/A
Industrial Production (YoY%)	10.0	9.7		8.6	8.8	8.7	8.8	9.2	9.0	6.9	8.0	7.7	7.2	7.9	N/A
PMI - Manufacturing (%)	51.4	51.0	50.5	50.2	50.3	50.4	50.8	51.0	51.7	51.1	51.1	50.8	50.3	50.1	49.8
PMI - Non-manufacturing (%)	56.0	54.6	53.4	55.0	54.5	54.8	55.5	55.0	54.2	54.4	54.0	53.8	53.9	54.1	53.7
FAI(YTD) (YoY%)	19.9	19.6		17.9	17.6	17.3	17.2	17.3	17.0	16.5	16.1	15.9	15.8	15.7	N/A
CPI (YoY%)	3.0	2.5	2.5	2.0	2.4	1.8	2.5	2.3	2.3	2.0	1.6	1.6	1.4	1.5	0.8
PPI (YoY%)	(1.4)	(1.4)	(1.6)	(2.0)	(2.3)	(2.0)	(1.4)	(1.1)	(0.9)	(1.2)	(1.8)	(2.2)	(2.7)	(3.3)	(4.3)
M2(YoY%)	14.2	13.6	13.2	13.3	12.1	13.2	13.4	14.7	13.5	12.8	12.9	12.6	12.3	12.2	12.6
New Lending (RMB/bn)	624.6	482.5	1,320	644.5	1,050	774.7	870.8	1,080	385.2	702.5	857.2	548.3	852.7	697.3	1,400.0
Aggregate Financing (RMB bn)	1,226.9	1,232.2	2,580	938.7	2,081.3	1,550	1,400	1,970	273.7	957.7	1,135.5	662.7	1,146.3	1,690.0	2,860.4

\* Forecast (Excluding PMI - Manufacturing and PMI - Non-manufacturing, CPI, PPI, Export, Import, Trade balance)

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)		
<b>U.S.</b>				<b>Energy</b>				US Fed Fund Rate	0.25	0.00		
DJIA	17,868.76	0.25	16.06	NYMEX WTI	USD/bbl	50.29	(2.71)	559,481	US Prime Rate	3.25	0.00	
S&P 500	2,068.59	0.64	18.15	ICE Brent Oil	USD/bbl	56.65	(1.99)	264,511	US Discount Window	0.75	0.00	
NASDAQ	4,787.65	0.91	30.73	NYMEX Natural Gas	USD/MMBtu	2.72	5.58	141,978	US Treasury (1 Yr)	0.2285	(1.53)	
MSCI US	1,977.98	0.64	18.60	Australia Newcastle Steam Coal Spot fob <sup>2</sup>	USD/Metric Tonne	61.80	N/A	N/A	US Treasury (5Yr)	1.4874	0.86	
<b>Europe</b>				<b>Basic Metals</b>				US Treasury (10 Yr)	1.9756	1.89		
FTSE 100	6,828.03	(0.37)	21.50	LME Aluminum Cash	USD/MT	1,815.75	(2.18)	18,145	Japan 10-Yr Gov. Bond	0.3950	5.60	
DAX	10,779.32	(0.62)	18.47	LME Aluminum 3 -mth. Rolling Fwd.	USD/MT	1,836.00	(1.87)	29,518	China 10-Yr Gov. Bond	3.4300	(3.00)	
CAC40	4,689.89	(0.02)	25.77	CMX Copper Active	USD/lb.	5,608.50	(1.15)	9,678	ECB Rate (Refinancing)	0.05	0.00	
IBEX 35	10,513.10	(0.57)	21.18	LME Copper 3- mth Rolling Fwd.	USD/MT	5,595.00	(0.97)	46,067	1-Month LIBOR	0.1722	0.07	
FTSE MIB	20,784.04	0.11	85.29	<b>Precious Metals</b>				3 Month LIBOR	0.2584	0.28		
Stoxx 600	373.28	(0.01)	23.39	CMX Gold	USD/T. oz	1,236.10	0.12	128,980	O/N SHIBOR	2.9320	7.60	
MSCI UK	2,006.70	(0.40)	21.32	CMX Silver	USD/T. oz	16.99	1.74	44,248	1-mth SHIBOR	5.0440	0.10	
MSCI France	132.65	0.10	27.24	NYMEX Platinum	USD/T. oz	1,210.30	(0.93)	10,392	3-mth HIBOR	0.3879	0.00	
MSCI Germany	143.78	(0.84)	18.75	<b>Agricultural Products</b>				Corporate Bonds (Moody's)				
MSCI Italy	59.27	(0.08)	85.97	CBOT Corn	USD/bu	387.25	0.39	188,885	Aaa	3.52	0.00	
<b>Asia</b>				CBOT Wheat	USD/bu	517.50	(1.80)	79,663	Baa	4.49	(1.00)	
NIKKEI 225	17,652.68	0.02	20.17	NYB-ICE Sugar	USD/lb.	14.69	0.75	81,262	Note:			
S&P/ASX 200	5,769.08	(0.88)	19.91	CBOT Soybeans	USD/bu.	969.50	(0.41)	121,727	1. Data sources: Bloomberg, National Bureau of Statistics of China, ABCIS (updated on date of report)			
HSI	24,315.02	(1.48)	10.28									2. Australia Newcastle Steam Coal Spot fob is the Australia Newcastle 6700 kc GAD fob Steam Coal Spot price published by McCloskey
HSCEI	11,651.01	(0.40)	8.22									
CSI300	3,434.12	3.67	15.14									
SSE Composite	3,157.70	2.66	15.16									
SZSE Composite	1,533.32	2.55	37.21									
MSCI China	67.71	(0.49)	10.20									
MSCI Hong Kong	13,114.55	(0.29)	10.78									
MSCI Japan	879.12	0.68	16.02									

Currency

	Euro/USD	GBP/USD	AUD/USD	USD/JPY	USD/CHF	USD/CNY	USD/HKD	USD/CNY NDF 12-mth Spot pr.
Spot Rate	1.1313	1.5263	0.7758	119.76	0.9272	6.2423	7.7540	6.3690
Chg. WTD (%)	(0.03)	0.13	(0.49)	(0.53)	(0.04)	0.04	(0.01)	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 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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**Office address: ABCI Securities Company Limited, 13/F Fairmont House,  
8 Cotton Tree Drive, Central, Hong Kong.**

**Tel: (852) 2868 2183**