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More RRR cut to come

The People's Bank of China (PBOC) announced on February 4, 2015 a 50bp cut in the required reserve ratio (RRR), effective February 5 2015. This is the first system-wide RRR cut since May 2012. China's large banks will see their ratio reduced from 20.0% to 19.5%. Overall, the cut will free up more than RMB 600 billion in potential credit.

Timing is in line with our expectation. Our forecast in December for an RRR cut (details please refer to our previous report, 2015 Economic Outlook and Investment Strategy: A Slow-Motion Growth, dated December 10, 2014) was based on our understanding that PBOC tends to signal policy easing and encourage loan growth in a gradual manner. With inflation softening further in recent months and liquidity decreasing before the Spring Festival, an RRR cut is much needed to sustain economic growth.

More than RMB 600 billion will be injected into the economy. The government's current focus is on stimulating aggregate demand to alleviate the impacts of a slowing economy. The RRR cut on Wednesday works in conjunction with the earlier liquidity injection through the "reverse-repo" operations. Both are parts of a concerted effort to avoid a sharp downturn in the economy by fine-tuning with policy tools.

Monetary easing before NPC opening. China's National People Congress (NPC) will convene in early March. Given the current economic slowdown, the NPC's focus this year will be on fostering domestic demand through stimulus measures. The latest RRR cut announced prior to the opening of NPC denotes the government's intention to loosen its purse strings to ensure ample liquidity in the economy.

Next RRR cut will likely take place in 2H15. PBOC reiterated its prudent stance on monetary policy and emphasized its aim of ensuring "adequate" liquidity in the banking system to boost economic growth. With inflation at bay, we forecast PBOC would lower RRR again in 2H15. RRR cuts will be deployed as the principal tool to stimulate the economy.

Greater lending momentum to improve market sentiment. Lower-than-expected new loans in December have sparked concerns that China's growth may moderate further amid uncertainties in the global economy. We believe the latest RRR cut will boost lending momentum in 1H15 and lower market risk premium, improving sentiment conducive to a market rally.



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	4.5
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)	(3.5)
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	47.0
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	1.0
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)	(3.5)
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)

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	17,673.02	2.96	15.89	NYMEX WTI	USD/bbl	48.96	1.49	490,912	0.25	0.00	
S&P 500	2,041.51	2.33	17.96	ICE Brent Oil	USD/bbl	54.97	3.74	349,608	3.25	0.00	
NASDAQ	4,716.70	1.76	33.51	NYMEX Natural Gas	USD/MMBtu	2.67	(0.78)	121,123	0.75	0.00	
MSCI US	1,951.54	2.32	18.37	Australia Newcastle Steam Coal Spot fob ²	USD/Metric Tonne	61.80	N/A	N/A	0.1929	5.59	
Europe			Basic Metals				US Treasury (1 Yr)				
FTSE 100	6,860.02	1.64	21.65	LME Aluminum Cash	USD/MT	1,862.00	0.45	26,089	1.2451	9.03	
DAX	10,911.32	2.03	18.36	LME Aluminum 3 -mth. Rolling Fwd.	USD/MT	1,878.00	0.75	34,400	1.7402	9.95	
CAC40	4,696.30	2.00	26.71	CMX Copper Active	USD/lb.	5,738.75	3.55	11,287	0.4060	12.80	
IBEX 35	10,577.80	1.68	21.35	LME Copper 3- mth Rolling Fwd.	USD/MT	5,705.00	3.82	56,316	3.4900	(2.00)	
FTSE MIB	20,941.73	2.14	N/A	Precious Metals				China 10-Yr Gov. Bond			
Stoxx 600	372.10	1.38	23.59	CMX Gold	USD/T. oz	1,272.80	(0.50)	167,309	0.05	0.00	
MSCI UK	2,015.18	1.60	21.11	CMX Silver	USD/T. oz	17.47	1.49	48,136	0.1710	(0.03)	
MSCI France	132.52	1.98	28.03	NYMEX Platinum	USD/T. oz	1,243.00	0.39	11,030	0.2551	0.20	
MSCI Germany	145.77	2.02	18.63	Agricultural Products				O/N SHIBOR			
MSCI Italy	59.94	1.90	N/A	CBOT Corn	USD/bu	382.50	3.38	191,747	2.8660	5.30	
Asia							1-mth SHIBOR				
NIKKEI 225	17,499.21	(0.99)	19.87	CBOT Wheat	USD/bu	508.75	1.19	67,583	5.0502	4.02	
S&P/ASX 200	5,794.10	3.68	20.02	NYB-ICE Sugar	USD/lb.	14.45	(2.30)	75,931	0.3871	0.07	
HSI	24,761.48	1.04	10.47	CBOT Soybeans	USD/bu.	973.25	1.27	121,851	Corporate Bonds (Moody's)		
HSCEI	11,862.60	1.22	8.37					Aaa		3.42	13.00
CSI300	3,426.43	(0.23)	15.11					Baa		4.40	11.00
SSE Composite	3,184.06	(0.82)	15.26								
SZSE Composite	1,538.58	1.73	37.36								
MSCI China	68.28	0.95	10.29								
MSCI Hong Kong	13,120.38	(0.54)	10.78								
MSCI Japan	872.46	0.26	15.73								

Note:

1. Data sources: Bloomberg, National Bureau of Statistics of China, ABCIS (updated on date of report)
2. Australia Newcastle Steam Coal Spot fob is the Australia Newcastle 6700 kc GAD fob Steam Coal Spot price published by McCloskey

Currency

	Euro/USD	GBP/USD	AUD/USD	USD/JPY	USD/CHF	USD/CNY	USD/HKD	USD/CNY NDF 12-mth Spot pr.
Spot Rate	1.1349	1.5188	0.7779	117.18	0.9234	6.2543	7.7536	6.3850
Chg. WTD (%)	0.51	0.85	0.22	0.26	(0.35)	(0.06)	(0.02)	0.16



Disclosures

Analyst Certification

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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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