



Economics Weekly April 20, 2015

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Larger RRR cut to combat stagnation

The People's Bank of China (PBOC) announced a 100bp cut in the required reserve ratio (RRR), effective April 20 2015. This is the second system-wide RRR cut in two months, with the size doubling that of the previous cut in February. China's large banks will see their ratio reduced from 19.5% to 18.5%, while additional RRR cuts of 1% will be given to commercial banks for agricultural services and 2% to the Agricultural Development Bank of China. PBOC will further lower RRR by 0.5% for eligible banks lending to agricultural borrowers or small and micro businesses. Overall, the RRR reduction will free up more than RMB 1.2 trillion in potential credit. The larger RRR cut indicates PBOC is strengthening efforts to reinvigorate the cooling economy.

Stagnant economic momentum has triggered the cut. China's 1Q15 GDP growth reached 7% YoY, the lowest in six years. Major macro indicators decelerated across the board on slower-than-expected recovery in consumption, investment and external trade. M2 growth and aggregate financing to the real economy were far below expectation, aggravating concerns of the economic downside risk. To avoid further moderation in 2Q15 and 3Q15, PBOC is strengthening its monetary tools to revive momentum.

Timing in line with our expectation. Our forecast of an RRR cut in 2Q15 was based on PBOC's tendency to conduct policy easing and encourage loan growth in a gradual manner. With inflation softening further in recent months, a larger-than-expected RRR cut is much needed to sustain economic growth.

More than RMB 1.2 trillion will be released to revive economic momentum. The government's current focus is to stimulate aggregate demand amid a slowing economy. The RRR cut on Monday, together with the "reverse-repo" operation, will inject more liquidity into the economy—both are part of a concerted effort by the government to avoid a sharp downturn in the economy.

Rate cut in 2Q15 - the next move in monetary loosening. PBOC reiterates its prudent stance on monetary policy and emphasizes its goal to ensure "adequate" liquidity in the banking system. After a substantial RRR cut, we forecast PBOC would lower interest rate in 2Q15 to stimulate the economy.

More aggressive macro easing in a world of loosened credit. ECB's QE and rate cuts by both developed and developing economies have released liquidity into the regional economies, placing more pressure on China to sustain momentum through policy easing. Uncertainty in the global economy, a weakening real estate market, and moderating domestic demand will prompt China to launch more aggressive monetary easing and fiscal measures to support the economy in the rest of 2015.



China Economic Indicators

	2014												2015		
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Real GDP (YoY%)	---	---	7.4	---	--	7.5	--	---	7.3	---	---	7.3	---	---	7.0
Export Growth (YoY%)	10.6	(18.1)	(6.6)	0.9	7.0	7.2	14.5	9.4	15.3	11.6	4.7	9.7	(3.2)	48.3	(15.0)
Import Growth (YoY%)	10.0	10.1	(11.3)	0.8	(1.6)	5.5	(1.6)	(2.4)	7.0	4.6	(6.7)	(2.4)	(19.7)	(20.5)	(12.7)
Trade Balance (USD/bn)	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	60.6	3.1
Retail Sales Growth (YoY%)	11.8		12.2	11.9	12.5	12.4	12.2	11.9	11.6	11.5	11.7	11.9	10.7		10.2
Industrial Production (YoY%)	8.6		8.8	8.7	8.8	9.2	9.0	6.9	8.0	7.7	7.2	7.9	6.8		5.6
PMI - Manufacturing (%)	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	49.9	50.1
PMI - Non-manufacturing (%)	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	53.9	53.7
FAI(YTD) (YoY%)	17.9		17.6	17.3	17.2	17.3	17.0	16.5	16.1	15.9	15.8	15.7	13.9		13.5
CPI (YoY%)	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	1.4	1.4
PPI (YoY%)	(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)	(4.8)	(4.6)
M2(YoY%)	13.2	13.3	12.1	13.2	13.4	14.7	13.5	12.8	12.9	12.6	12.3	12.2	10.8	12.5	11.6
New Lending (RMB/bn)	1,320	644.5	1,050	774.7	870.8	1,080	385.2	702.5	857.2	548.3	852.7	697.3	1,470.0	1,020	1,180
Aggregate Financing (RMB bn)	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	2,050.0	1,350	1,180

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	17,826.30	0.00	15.26	NYMEX WTI	USD/bbl	56.51	1.38	387,898		0.25	0.00
S&P 500	2,081.18	0.00	18.06	ICE Brent Oil	USD/bbl	64.20	1.18	152,181	US Prime Rate	3.25	0.00
NASDAQ	4,931.81	0.00	29.32	NYMEX Natural Gas	USD/MMBtu	2.58	(1.90)	139,705	US Discount Window	0.75	0.00
MSCI US	1,995.07	0.00	18.59	Australia Newcastle Steam Coal Spot fob ²	USD/Metric Tonne	61.80	N/A	N/A	US Treasury (1 Yr)	0.2036	0.00
Europe				Basic Metals				US Treasury (5Yr)			
FTSE 100	6,994.63	0.00	23.83	LME Aluminum Cash	USD/MT	1,834.25	0.00	40,241	US Treasury (10 Yr)	1.8687	0.34
DAX	11,688.70	0.00	19.45	LME Aluminum 3 -mth. Rolling Fwd.	USD/MT	1,815.00	0.00	46,019	Japan 10-Yr Gov. Bond	0.3170	0.90
CAC40	5,143.26	0.00	26.59	CMX Copper Active	USD/lb.	6,071.00	0.00	16,785	China 10-Yr Gov. Bond	3.7000	12.00
IBEX 35	11,359.40	0.00	21.47	LME Copper 3- mth Rolling Fwd.	USD/MT	6,060.00	0.00	45,702	ECB Rate (Refinancing)	0.05	0.00
FTSE MIB	23,044.08	0.00	86.89	Precious Metals				1-Month LIBOR			
Stoxx 600	403.69	0.00	24.59	CMX Gold	USD/T. oz	1,204.10	0.08	133,027	3 Month LIBOR	0.2758	(0.13)
MSCI UK	2,055.48	0.00	24.22	CMX Silver	USD/T. oz	16.24	0.07	41,329	O/N SHIBOR	2.0870	(18.1)
MSCI France	144.73	0.00	27.52	NYMEX Platinum	USD/T. oz	1,169.30	0.15	9,317	1-mth SHIBOR	4.1460	(16.8)
Asia				Agricultural Products				3-mth HIBOR			
NIKKEI 225	19,709.66	0.29	22.28	CBOT Corn	USD/bu	387.50	0.19	118,736	Corporate Bonds (Moody's)		
S&P/ASX 200	5,829.60	(0.82)	21.00	CBOT Wheat	USD/bu	491.75	0.51	80,350	Aaa	3.47	(6.00)
HSI	27,569.48	(0.30)	11.55	NYB-ICE Sugar	USD/lb.	13.18	0.00	90,322	Baa	4.45	(4.00)
HSCEI	14,541.57	0.03	10.35	CBOT Soybeans	USD/bu.	978.00	0.67	89,509			
CSI300	4,652.61	1.23	20.06								
SSE Composite	4,331.28	1.03	21.35								
SZSE Composite	2,137.71	0.07	49.94								
MSCI China	83.02	0.00	12.75								
MSCI Hong Kong	14,206.48	0.00	10.66								
MSCI Japan	978.29	0.00	17.96								

Currency

	Euro/USD	GBP/USD	AUD/USD	USD/JPY	USD/CHF	USD/CNY	USD/HKD	USD/CNY NDF 12-mth Spot pr.
Spot Rate	1.0788	1.4960	0.7804	118.90	0.9535	6.2026	7.7502	6.2820
Chg. WTD (%)	(0.17)	(0.01)	0.28	0.00	(0.15)	(0.08)	0.02	0.05

Note:

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



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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