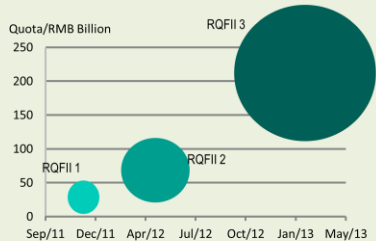




Economics Weekly

Expansion of RQFII program



	RQFII 1	RQFII 2	RQFII 3
Announced date	Dec-11	Apr-12	November, 2012, January & March 2013
Quota / RMB Bn	20	50	200
Investment mandate	80% in bonds 20% in equity	Issued A share ETF denominated in RMB listed on HKEX	Allows participants to invest in more products
Participants	The Hong Kong subsidiaries of security brokerage (12) & fund management firms (9) from China	Similar to the criteria in RQFII 1, 4 fund management companies were approved	Extended to licensed Hong Kong branches of Chinese banks and insurance companies, and local financial institutions

Source: CSRC website <http://www.csrc.gov.cn>

Kicking off a new era of financial reform

Reforming China's financial sector, regarded as essential for sustaining economic growth, becomes a top priority in facilitating China's rebalancing away from an export-driven to consumption-focused economy. Just one day after the NPC began, the China Securities Regulatory Commission (CSRC) announced the expansion of RQFII program by allowing a wider variety of financial institutions to participate in domestic financial market and lifting the restrictions on asset allocation. This signals the government's determination to liberalize the capital market in China and enhance renminbi's international influence. Financial reforms would be high on the government's agenda and policymakers will step up commitment to their plans this year including reforms regarding the marketization of exchange and interest rates and the convertibility of the renminbi under China's capital account, as well as policies to boost bond market, securitize assets and encourage more private capital to enter the financial sector.

- **More opportunities for financial institutions under the new round of RQFII.** The new RQFII lifts some of the restrictions on the qualification of investors and expands the investments scope of RQFII products to stocks and other financial instruments in China. The current RQFII quota is RMB 270bn and China could boost the current level for foreign investors by 10-fold in the near future. Overseas investors will be more flexible to use renminbi to buy A-shares and other mainland investment products through the RQFII program which will facilitate stock and bond issuance in financial markets of HK and China as well as promote the launch of cross-border exchange traded fund products.
- **Wider renminbi trading band.** Widening the renminbi's trading band aims to promote exchange of the renminbi, boost the two-way fluctuation flexibility and improve the market-based managed floating exchange rate regime tied to a basket of foreign currencies. Since April 2012, renminbi trading band has been widened to 1% against US dollar. We expect the trading band will be further widened to 2% this year with which a wider trading band is conducive to enhancing the flexibility of the exchange rate which will make it easier to use renminbi in international trade and capital investment. This will increase the pool of renminbi used in the international arena, thus achieving the goal of renminbi internationalization.
- **Acceleration of interest rate liberalization.** Two-way renminbi flows into and out of China would result in a stable renminbi exchange rate. However, China's base interest rate is set by the government instead of by the market, which tends to

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distort the arbitrage that would normally bring the exchange rate to equilibrium. In an effort to mitigate this, the government has emphasized the importance of implementing a more market-oriented interest rate mechanism by allowing partial interest rate liberalization in 2012. We expect the liberalization of interest rates will be pushed forward progressively in 2013 by enhancing banks' flexibility to set interest rates. This allows market forces to play a greater role in capital allocation and will help shift the balance of the economy towards consumption as higher bank deposit rates would give households more spending power.

- **Debt market reform in spotlight.** Expanding China's bond market, which is critical for reducing the concentration of financial risk in the banking system, is expected to be an important goal for policymakers. We expect the CSRC will speed up the development of the bond market by unifying all of the regulators' separate bond-disclosure, credit-rating, investor-protection and entry standards. It will also give corporate bonds a bigger role in boosting growth and diverting risk from the state-owned banking system.
- **Demand for renminbi set to increase.** China is committed to liberalizing its capital account and internationalize renminbi. This will sustain high demand for renminbi financial products. We expect robust economic outlook and financial reforms will lead to a 2% appreciation of the currency in 2013.
- **Beneficiaries of financial reforms in China.** We believe the financial sector will be the major beneficiary of the new initiatives in China. We favor **BOC Hong Kong (2388 HK)** and **Hang Seng Bank (11 HK)** as they have a large pool of offshore renminbi deposits for cross-border renminbi loans and renminbi business. Asset management company such as **Value Partners (806 HK)** will also benefit from liberalization of China's capital market. Some mainland listed brokers such as **Citic Securities (6030 HK)**, **Haitong Securities (6837 HK)**, **Guotai Junan International (1788 HK)** and **Shenyin Wanguo HK (218 HK)** will stand to benefit from financial reforms in China.



China Economic Indicators

	2012										2013	
	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
Real GDP (YoY%)	8.1	---	---	7.6	---	---	7.4	---	---	7.9	---	---
Export Growth (YoY%)	8.9	4.9	15.3	11.1	1	2.7	9.9	11.6	2.9	14.1	25.0	21.8
Import Growth (YoY%)	5.3	0.3	12.7	6.3	4.7	-2.6	2.4	2.4	0	6	28.8	-15.2
Trade Balance (USD/Bn)	5.18	18.53	18.13	31.91	25.28	26.43	27.45	32.11	19.63	31.6	29.2	15.3
Retail Sales Growth (YoY%)	15.2	14.1	13.8	13.7	13.1	13.2	14.2	14.5	14.9	15.2	12.3	
Industrial Production (YoY%)	11.9	9.3	9.6	9.5	9.2	8.9	9.2	9.6	10.1	10.3	9.9	
PMI - Manufacturing (%)	53.1	53.3	50.4	50.2	50.1	49.2	49.8	50.2	50.6	50.6	50.4	50.1
PMI - Non-manufacturing (%)	58	56.1	55.2	56.7	55.6	56.3	53.7	55.5	55.6	56.1	56.2	54.5
FAI(YTD) (YoY%)	20.9	20.2	20.1	20.4	20.4	20.2	20.5	20.7	20.7	20.6	21.2	
CPI (YoY%)	3.6	3.4	3	2.2	1.8	2	1.9	1.7	2	2.4	2.0	3.2
PPI (YoY%)	-0.3	-0.7	-1.4	-2.1	-2.9	-3.5	-3.6	-2.8	-2.2	-1.9	-1.6	-1.6
M2 (YoY%)	13.4	12.8	13.2	13.6	13.9	13.5	14.8	14.1	13.9	13.8	15.9	15.2
New Lending (CNY/Bn)	1011.44	681.8	793.23	919.83	540.1	703.9	623.2	505.2	522.9	454.3	1070.0	620.0

World Economic/Financial Indicators

Equity Index				Global Commodities				Bond Yields & Key Interest Rates				
	Closing price	Chng. WTD (%)	P/E		Unit	Price	Chng. WTD (%)	Volume (5-day average)		Yield (%)	Chng. WTD (%)	
US				Energy	NYMEX WTI	USD/bbl	92.89	1.02	235354.20	US Fed Fund Rate	0.25	0.00
DJIA	14450.06	0.37	14.08		ICE Brent	USD/bbl	109.26	-1.43	190921.80	US Prime Rate	3.25	0.00
S&P 500	1552.48	0.08	15.33		NYMEX Natural Gas	USD/MM Btu	3.66	0.77	129023.40	US Discount Window	0.75	0.00
NASDAQ	3242.32	-0.06	24.45		Australia Newcastle Steam Coal Spot fob	USD/Metric Tonne	92.35	N/A	N/A	US Treasury (1 Month)	0.0862	6.29
MSCI US	1482.94	0.07	15.64		LME Aluminum Cash	USD/MT	1939.00	0.82	28829.00	US Treasury (10 Yr)	2.0069	-1.75
Europe				Basic Metals	LME Primary Aluminum 3 Month Rolling Forward	USD/MT	1981.50	0.84	40823.40	US Treasury (30 Yr)	3.2007	-1.33
FTSE 100	6442.27	-0.64	18.17		CMX Copper Active Contract	USD/lb.	353.25	1.17	524.80	Japan 10-Yr Government Bond	0.633	-2.32
DAX	7954.88	-0.40	15.60		LME Copper 3 Month Rolling Forward	USD/MT	7830.00	1.16	47964.60	China 10-Yr Government Bond	3.6	0.28
CAC40	3819.51	-0.54	14.64		TSI CFR China Iron Ore Fines Index	USD	143.40	-1.98	N/A	ECB Interest Rate (Refinancing)	0.75	0.00
IBEX 35	8446.80	-2.10	28.44		CMX Gold	USD/T. oz	1595.20	1.16	155403.60	1-Month LIBOR	0.2032	0.49
FTSE MIB	15735.33	-2.89	N/A	CMX Silver	USD/T. oz	29.12	0.73	156.00	3 Month LIBOR	0.2801	0.00	
Stoxx 600	294.09	-0.49	22.47	NYMEX Platinum	USD/T. oz	767.65	-1.67	19.80	3-Month SHIBOR	3.8833	0.05	
MSCI UK	1928.34	0.40	18.39	CBOT Corn	USD/bu	744.00	2.59	2623.40	3-Month HIBOR	0.3807	-0.56	
MSCI France	107.61	-0.01	18.85	CBOT Wheat	USD/bu	700.50	1.52	271.80	Corporate Bonds (Moody's Seasoned)			
MSCI Germany	111.88	-0.28	15.33	NYB-ICE Sugar	USD/lb.	18.70	-0.27	59557.60	Aaa	4.02	0.00	
MSCI Italy	47.37	-0.75	N/A	CBOT Soybeans	USD/bu.	1488.00	-1.36	1980.00	Baa	4.94	0.00	
Asia				Precious Metals								
NIKKEI 225	12239.66	-0.36	24.56									
S&P/ASX 200	5092.40	-0.61	21.05									
HSI	22556.65	-2.32	11.23									
HSCEI	11037.41	-3.89	9.23									
CSI300	2527.49	-3.05	12.63									
SSE Composite	2263.97	-2.36	12.54									
SZSE Composite	927.08	-3.25	26.83									
MSCI China	62.15	-1.85	10.78									
MSCI Hong Kong	11890.86	-0.32	11.45									
MSCI Japan	641.88	1.67	22.71									
Currency												
									USD/CNY			
	Euro/USD	GBP/USD	AUD/USD	USD/JPY	USD/CHF	USD/CAD	USD/CNY	USD/HKD	NDF 12 Month			
Spot Exchange Rate	1.3009	1.4963	1.0309	95.7900	0.9462	1.0273	6.2142	7.7571	6.3015			
Chng. WTD (%)	0.03	0.25	0.71	0.22	0.55	0.14	0.03	0.00	0.17			

Note:

- Data source: Bloomberg Finance LP, National Bureau of Statistics of China, ABCIS
- Australia Newcastle Steam Coal Spot fob is the Australia Newcastle 6700 kc GAD job Steam Coal Spot price published by McCloskey
- TSI CFR China Iron Ore Fines Index is calculated with the 62% Fe specification, spot price
- Certain data is not reported as of the date of this report

**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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