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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

2014 China policy outlook

In accordance with China's economic growth and structural adjustment objectives, the country's economic policies will be more accommodating in 2014 than in 2013, orienting to prudent monetary accommodation and fiscal easing. The PBOC will remain largely neutral, adopting a supportive monetary stance to boost healthy growth and manage inflationary pressures. Deeper reforms to raise the quality of economic growth will also be emphasized.

The Fed's QE exit poses risks to the momentum of global economic recovery in 2014. The Fed's decision to start tapering the massive bond-buying program will alter the economic landscape of the global economy and the direction of capital flows, which will inevitably affect economic recovery of emerging markets. We believe China will take gradual approach to speed up economic reforms as QE's tapering may exacerbate the fragileness of China's financial system and expose the country to great risks.

Monetary policy – “Prudent” to release liquidity. As China will further open up its economy by broadening market access, boosting regional cooperation and opening up its interior and border cities, we believe that international capital will continue to flow into China, exerting greater pressure on the PBOC to manage liquidity. Continuous monitoring of market liquidity is necessary for China to control inflation preemptively. By further opening up the renminbi market, China may experience further liquidity inflow in 2014 and policymakers should remain vigilant to mounting inflationary risks. Accordingly, the PBOC's annual new bank loan growth target will be between RMB 9.5tr and RMB 9.8tr in 2014F compared to the 2013 target of RMB 9.0tr. Thus, M2 growth target will be 14.0% YoY vs. 14.2% in 2013. The lower new loan growth reflects a neutral monetary stance in 2014 and should be able to support a GDP growth of 7.6% YoY.

Fiscal policy – “Proactive” to boost domestic demand. China's current fiscal deficit as a percentage of GDP is less than 3% compared with 10% in the U.S. and 6% in the Eurozone, meaning that the country still has ample capacity for fiscal spending in 2014. The government will adopt an overall expansionary fiscal policy to facilitate the mega reform proposed in the Third Plenum. Such a move would be consistent with its objective of transforming the nation's economic structure over the medium term. The 383 plan involves a slew of reforms to open up the market, transform the government, and reform enterprises to boost innovations. A significant amount of fiscal resources will be needed to execute the reform package. Looking ahead, we expect more ambitious stimulus packages to emerge, including: (1) accelerated approvals for infrastructure and construction projects facilitating urbanization; (2) encouraging private capital to flow into large industrial sectors currently dominated by state firms and have high entry barriers; (3) tax reform to support the service sector, which includes enhancement of the experimental tax reform that entails conversion of a business tax to VAT; (4) reforming the fiscal system, which includes the set-up of basic social security; (5) promoting innovations such as green technology; (6) reducing the government's price intervention in the market; (7) opening up the service sector.



China Economic Indicators

	2012		2013										
	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Real GDP (YoY%)	---	7.9	---	---	7.7	---	---	7.5	---	---	7.8	---	---
Export Growth (YoY%)	2.9	14.1	25.0	21.8	10.0	14.7	1.0	(3.1)	5.1	7.2	(0.3)	5.6	12.7
Import Growth (YoY%)	0	6	28.8	(15.2)	14.1	16.8	(0.3)	(0.7)	10.9	7.0	7.4	7.6	5.3
Trade Balance (USD/bn)	19.63	31.6	29.2	15.3	(0.9)	18.2	20.4	27.1	17.8	28.5	15.2	31.1	33.8
Retail Sales Growth (YoY%)	14.9	15.2		12.3	12.6	12.8	12.9	13.3	13.2	13.4	13.3	13.3	13.7
Industrial Production (YoY%)	10.1	10.3		9.9	8.9	9.3	9.2	8.9	9.7	10.4	10.2	10.3	10
PMI - Manufacturing (%)	50.6	50.6	50.4	50.1	50.9	50.6	50.8	50.1	50.3	51.0	51.1	51.4	51.4
PMI - Non-manufacturing (%)	55.6	56.1	56.2	54.5	55.6	54.5	54.3	53.9	54.1	53.9	55.4	56.3	56
FAI(YTD) (YoY%)	20.7	20.6		21.2	20.9	20.6	20.4	20.1	20.1	20.3	20.2	20.1	19.9
CPI (YoY%)	2	2.4	2.0	3.2	2.1	2.4	2.1	2.7	2.7	2.6	3.1	3.2	3
PPI (YoY%)	(2.2)	(1.9)	(1.6)	(1.6)	(1.9)	(2.6)	(2.9)	(2.7)	(2.3)	(1.6)	(1.3)	(1.5)	(1.4)
(YoY%)	13.9	13.8	15.9	15.2	15.7	16.1	15.8	14.0	14.5	14.7	14.2	14.3	14.2
New Lending (RMB/bn)	522.9	454.3	1070.0	620.0	1060.0	792.9	667.4	860.5	699.9	711.3	787.0	506.1	624.6

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	
U.S.				Energy				US Fed Fund Rate			
DJIA	16,294.61	0.45	15.76	NYMEX WTI	USD/bbl	98.68	(0.64)	94,956		0.25	0.00
S&P 500	1,827.99	0.53	17.16	ICE Brent Oil	USD/bbl	111.48	(0.26)	154,145	US Prime Rate	3.25	0.00
NASDAQ	4,148.90	1.08	25.61	NYMEX Natural Gas	USD/MMBtu	4.48	1.40	131,945	US Discount Window	0.75	0.000
MSCI US	1,748.63	0.52	17.43	Australia Newcastle Steam Coal Spot fob ²	USD/Metric Tonne	84.55	N/A	N/A	US Treasury (1 Mth)	0.0051	1.02
Europe				Basic Metals				US Treasury (5 Yr)			
FTSE 100	6,678.61	1.09	16.46	LME Aluminum Cash	USD/MT	1,714.50	(1.47)	23,709	US Treasury (10 Yr)	2.9292	4.06
DAX	9,488.82	0.94	16.13	LME Aluminum 3 -mth. Rolling Fwd.	USD/MT	1,760.00	(1.40)	30,237	Japan 10-Yr Gov. Bond	0.6840	0.30
CAC40	4,215.29	0.51	18.07	CMX Copper Active	USD/lb.	331.15	0.11	35,045	China 10-Yr Gov. Bond	4.6300	2.00
IBEX 35	9,758.40	0.71	66.35	LME Copper 3- mth Rolling Fwd.	USD/MT	7,241.00	0.04	40,545	ECB Rate (Refinancing)	0.25	0.00
FTSE MIB	18,697.15	0.71	215.8	TSI CFR China Iron Ore Fines Index ³	USD	131.90	(0.60)	N/A	1-Month LIBOR	0.1646	0.06
Stoxx 600	323.40	0.70	21.36	Precious Metals				3 Month LIBOR			
MSCI UK	1,972.17	1.11	16.41	CMX Gold	USD/T. oz	1,197.50	(0.52)	142,376	O/N SHIBOR	4.1450	21.80
MSCI France	117.69	0.50	23.08	CMX Silver	USD/T. oz	19.36	(0.48)	37,250	1-mth SHIBOR	6.6050	(92.5)
MSCI Germany	130.29	0.91	15.77	NYMEX Platinum	USD/T. oz	1,327.20	(0.38)	14,289	3-mth HIBOR	0.3800	0.29
MSCI Italy	53.60	0.68	98.59	Agricultural Products				Corporate Bonds (Moody's)			
Asia				CBOT Corn	USD/bu	433.25	0.00	86,115	Aaa	4.49	(14.0)
NIKKEI 225	15,888.95	0.12	22.95	CBOT Wheat	USD/bu	608.75	(0.77)	43,472	Baa	5.27	(11.0)
S&P/ASX 200	5,327.20	1.18	21.90	NYB-ICE Sugar	USD/lb.	16.23	(1.34)	53,871			
HSI	23,179.55	1.61	10.51	CBOT Soybeans	USD/bu.	1,327.00	(0.90)	94,109			
HSCEI	10,834.43	1.94	8.04								
CSI300	2,292.87	0.65	10.93								
SSE Composite	2,095.64	0.52	10.50								
SZSE Composite	1,033.92	0.75	28.07								
MSCI China	62.08	0.39	9.80								
MSCI Hong Kong	12,073.06	0.63	10.93								
MSCI Japan	782.69	0.00	16.81								

Note:

- Data sources: Bloomberg Finance LP, 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
- TSI CFR China Iron Ore Fines Index is calculated with the 62% Fe specification, spot price

Currency

	Euro/USD	GBP/USD	AUD/USD	USD/JPY	USD/CHF	USD/CNY	USD/HKD	USD/CNY NDF 12-Mth
Spot Rate	1.3680	1.6344	0.8915	104.18	0.8948	6.0718	7.7540	6.1363
Chg. WTD (%)	0.05	0.05	(0.09)	(0.08)	0.16	(0.02)	0.01	0.04



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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**Office address: ABCI Securities Company Limited, 13/F Fairmont House,
8 Cotton Tree Drive, Central, Hong Kong.**

Tel: (852) 2868 2183