



Economic Insight

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China economic outlook for 2018

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- China's economic growth has rebounded slightly since the start of 2017 on better external demand and effective supply-side structure reform. Official figures show the world's second-largest economy expanded by 6.9% in the first three quarters of 2017, up from 6.7% in 2016.
- Although supply-side structural reform will continue to boost growth, we expect China's economic growth to slow slightly in 2018 on economic deleveraging, tightening environmental regulations, and housing market restrictions. We expect China's GDP to expand by 6.6% for 2018E, slightly slower than the estimated 6.8% in 2017E.
- CPI inflation is expected to rebound to 2.0% in 2018E from the estimated 1.5% in 2017E due to higher food prices and low base effect. We forecast PPI inflation to ease to 2.5% in 2018E from 6.0% in 2017E with the low base effect fading away and commodity prices moderating.
- On the monetary front, PBOC is expected to maintain a neutral monetary policy with a tightening bias to balance among the goals of lowering leverage ratio, preventing financial risks, and maintaining a steady growth. We expect benchmark interest rates and benchmark RRR to stay unchanged in 2018 given the stable growth momentum and benign inflation pressure.
- The central government is expected to maintain a proactive fiscal policy in 2018 through poverty eliminations, environmental protections, tax reductions, local debt swap schemes, and livelihood investments. We expect fiscal deficit ratio to approach to about 3.5% of GDP in 2018E.
- With the leadership transition successfully completed, we believe economic reform will accelerate in 2018 to support economic growth and improve environmental health. The widely supported reform measures, which include the green development, rural land reform, income distribution reform, state-owned enterprise reform, fiscal system reform, and financial reform, will be launched on schedule.
- With concerns of air pollution escalating and China's emphasis on sustainable development and growth quality, we believe the environmental protection, clean energy and healthcare sectors would enjoy higher growth and better profitability than most sectors in 2018. Also, we expect the new economy sector will continue to exhibit high profitability and earnings quality.

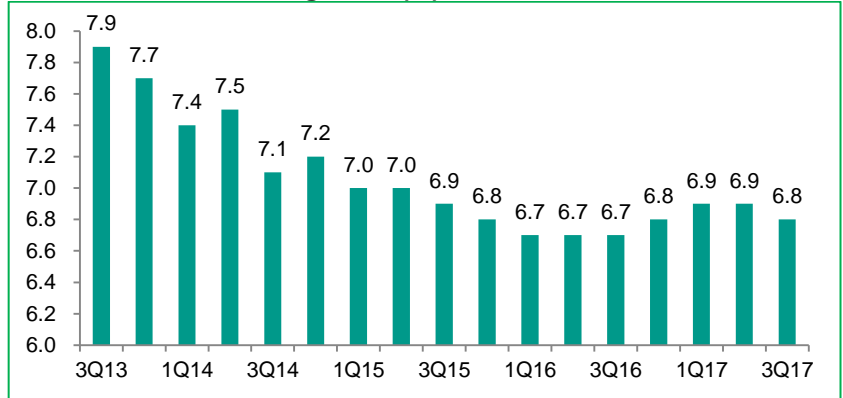
China's economic growth picked up slightly in 10M17

China economic growth has rebounded slightly since the start of 2017 on better external demand and effective supply-side structure reform. Official figures show the world's second-largest economy expanded by 6.9%¹ in the first three quarters of 2017, up from 6.7% in 2016 (Exhibit 1). Notably, China's economic rebalancing continues, with consumption contributing to 64.5% of economic growth and tertiary sector accounting for 52.9% of GDP in 9M17. The contribution of net exports of goods and services to economic growth turned to 0.2ppt in 9M17 from -0.4ppt in 2016.

¹ All growth rates are year-on-year except specified otherwise



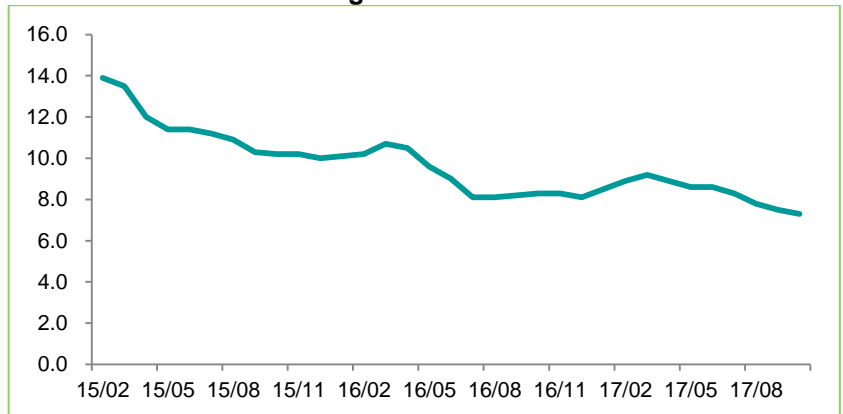
Exhibit 1: China's GDP growth (%)



Source(s): NBS, ABCI Securities

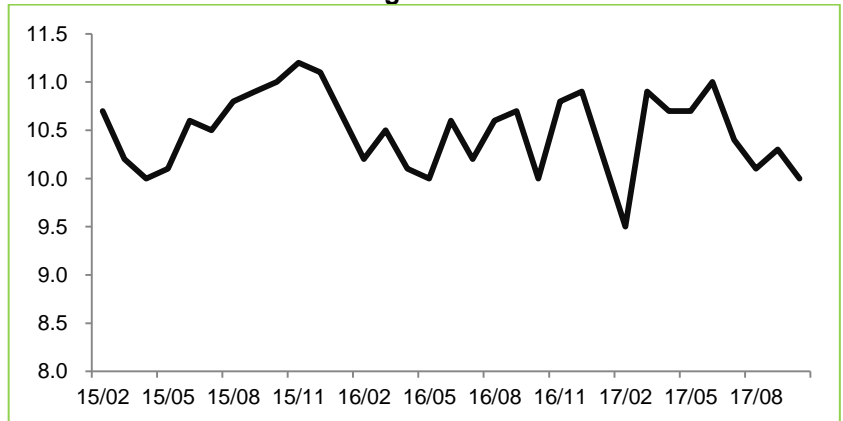
Compared with 2016, domestic demand showed weakness, with both investment and retail sales growth declining in 10M17. Fixed asset investment (FAI) in urban areas advanced 7.3% after rising 8.1% in 2016 (Exhibit 2), and retail sales of consumer goods grew 10.3% after increasing 10.4% (Exhibit 3). After adjusting for inflation, real growth retail sales slowed to 9.2% in 10M17 from 9.6% in 2016. On the production side, the real growth of industrial output climbed to 6.7% in 10M17 on rebounding PPI inflation, compared with 6.0% in 2016.

Exhibit 2: China's FAI YTD growth



Source(s): NBS, ABCI Securities

Exhibit 3: China's retail sales growth

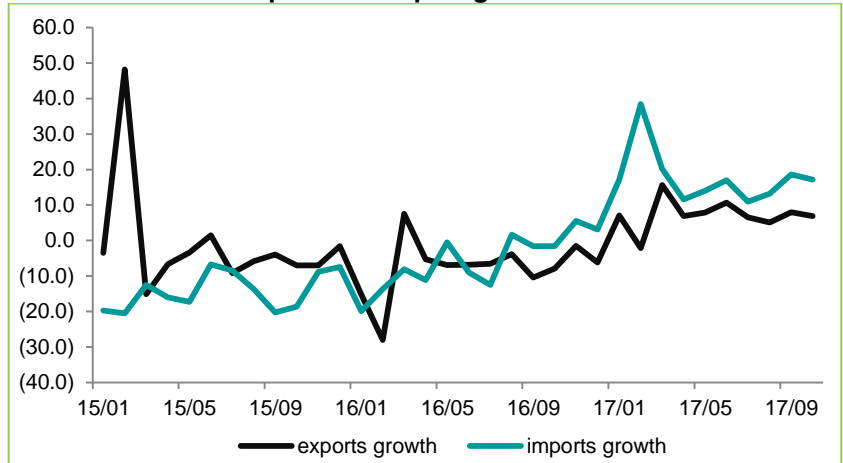


Source(s): NBS, ABCI Securities



On the external front, both exports and imports rebounded significantly in 10M17 (Exhibit 4). The USD value of China's exports grew by 7.4% in 10M17 on the back of improving global economic activity, well above the 7.7% decrease in 2016. Imports climbed 17.2% in 10M17, compared with the 5.5% drop last year. With the substantial import growth, trade balance narrowed to US\$ 334.8bn in 10M17 from US\$ 441.6bn in 10M16.

Exhibit 4: China's export and import growth



Source(s): NBS, ABCI Securities

Inflation diverged in 10M17. CPI inched down to 1.5% in 10M17 from 2.0% in 2016, driven by the deceleration in food prices. However, PPI rebounded significantly to 6.5% in from -1.3% during the same period due to ongoing capacity reduction, rebounding commodity and material prices, as well as low base effect.

On the monetary front, PBOC maintained a neutral monetary policy with a tightening bias on the ongoing deleveraging. CBRC also strengthened financial regulation, particularly in the area of shadow banking system. Growth in broad money supply (M2) decelerated to 8.8% in October 2017 from 11.3% in December 2016. The government bond yields and seven-day repurchase rate, which measures short-term funding costs, trended upwards.

Economic outlook for 2018

Although supply-side structural reform will continue to boost growth, we expect China's economic growth to slow in 2018 due to economic deleveraging, tightening environmental regulations, and housing market restrictions. Strong external demand and steady consumer spending will be the main growth drivers. On the contrary, high debt burden and potential geopolitical conflicts would be the major challenges.

Domestically, investment growth is expected to ease as the tightening policies in the property market and rising financial rates would weigh on growth in property investment growth while growth in infrastructure investment would ease due to slower fiscal revenue growth. Manufacturing investment and private investment would expand steadily. Increasing income and low unemployment rate would help underpin consumer spending. Externally, despite strong global demand, export growth is expected to moderate on high base



effect. For these reasons, we expect China's economy to grow by 6.6% for 2018E, slightly slower than the estimated 6.8% in 2017E (Exhibit 5).

Exhibit 5: Economic forecasts

Economic indicators	2016	2017E	2018E
Real GDP growth, %	6.7	6.8	6.6
FAI growth, %	8.1	7.5	7.0
Retail Sales growth, %	10.4	10.5	10.5
Export growth in USD terms, %	-7.7	8.0	3.0
Import growth in USD terms, %	-5.5	14.0	5.0
Industrial Production growth, %	6.0	6.5	6.0
CPI, %	2.0	1.5	2.0
PPI, %	-1.4	6.0	2.5
M2 growth, %	11.3	9.0	9.0
Aggregate Financing, RMB bn	17,800	20,000	22,000
New Yuan Loans, RMB bn	12,600	13,500	14,500
Spot CNY per USD, End-year	6.9450	6.5500	6.8500

Source(s): NBS, PBOC, ABCI Securities estimates

CPI inflation is expected to rebound to 2.0% in 2018E from the estimated 1.5% in 2017E due to higher food prices and low base effect. We forecast PPI inflation to ease to 2.5% in 2018E from estimated 6.0% in 2017E with the low base effect fading away and commodity prices moderating.

On the monetary front, PBOC is expected to maintain a neutral monetary policy with a tightening bias to balance among goals to lower leverage ratio, prevent financial risks, and maintain a steady growth. We expect benchmark interest rates and benchmark RRR to stay unchanged in 2018 given the stable growth momentum and benign inflation pressure, while the targeted RRR cut will be effective in early 2018 to support inclusive finance and real economy. The central bank will likely continue to employ measures such as open market operation, short-term liquidity operations, standing lending facility, and medium-term lending facility to maintain sufficient liquidity. Broad money supply (M2) is set to grow by about 9.0%, and new RMB-denominated loans and new aggregate financing would reach about RMB 14.5tr and about RMB 22.0tr in 2018E. Regarding the exchange rate, we expect spot USD/CNY rate to approach 6.8500 by end-2018E with the rising U.S. interest rates, as compared to the estimated 6.5500 at end-2017E.

The central government is expected to maintain a proactive fiscal policy in 2018 through poverty eliminations, environmental protections, tax reductions, local debt swap schemes, and livelihood investments. We expect faster growth in fiscal expenditure than fiscal revenue to result in another small fiscal deficit in 2018, with the headline ratio approaching to about 3.5% of GDP.

The Communist Party of China held its 19th Congress during the October 18-24 period. With the leadership transition successfully completed, we believe economic reform will accelerate in 2018 to support economic growth and improve environmental health. The widely supported reform measures, which include the green



development, rural land reform, income distribution reform, state-owned enterprise reform, fiscal system reform, and financial reform, will be rolled out on schedule.

With concerns of air pollution escalating and China's emphasis on sustainable development and growth quality, we believe the environmental protection, clean energy and healthcare sectors would enjoy higher growth and better profitability than most sectors in 2018. Also, we expect new economy sector, which is seen as one that utilizes internet technology to create new products and services, will continue to enjoy high profitability and earnings quality.



China Economic Indicators

	2016				2017									
	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
Real GDP (YoY %)	6.7	---	---	6.8	---	---	6.9	---	---	6.9	---	---	6.8	---
Export Growth (USD, YoY %)	(10.0)	(7.3)	0.1	(6.1)	7.9	(1.3)	16.4	8.0	8.7	11.3	7.2	5.5	8.1	6.9
Import Growth (USD, YoY %)	(1.9)	(1.4)	6.7	3.1	16.7	38.1	20.3	11.9	14.8	17.2	11.0	13.3	18.7	17.2
Trade Balance (USD bn)	42.0	49.1	44.6	40.8	51.3	(9.1)	23.9	38.0	40.8	42.8	46.7	42.0	28.5	38.2
Retail Sales Growth (YoY %)	10.7	10.0	10.8	10.9	9.5	9.5	10.9	10.7	10.7	11.0	10.4	10.1	10.3	10.0
Industrial Production (YoY %)	6.1	6.1	6.2	6.0	6.3	6.3	7.6	6.5	6.5	7.6	6.4	6.0	6.6	6.2
PMI - Manufacturing (%)	50.4	51.2	51.7	51.4	51.3	51.6	51.8	51.2	51.2	51.7	51.4	51.7	52.4	51.7
PMI - Non-manufacturing (%)	53.7	51.2	50.9	51.9	54.6	54.2	55.1	54.0	54.5	54.9	54.5	53.4	55.4	54.5
FAI (YTD) (YoY %)	8.2	8.3	8.3	8.1	8.9	8.9	9.2	8.9	8.6	8.6	8.3	7.8	7.5	7.3
CPI (YoY %)	1.9	2.1	2.3	2.1	2.5	0.8	0.9	1.2	1.5	1.5	1.4	1.8	1.6	1.9
PPI (YoY %)	0.1	1.2	3.3	5.5	6.9	7.8	7.6	6.4	5.5	5.5	5.5	6.3	6.9	6.9
M2 (YoY %)	11.5	11.6	11.4	11.3	11.3	11.1	10.6	10.5	9.6	9.4	9.2	8.9	9.2	8.8
New Lending (RMB bn)	1220	651	795	1040	2030	1170	1020	1100	1110	1540	826	1090	1270	663
Aggregate Financing (RMB bn)	1720	896	1740	1630	3740	1150	2120	1390	1060	1780	1220	1480	1820	1040

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	1.25	0.00	
DJIA	23,580.78	0.10	19.81	NYMEX WTI	USD/bbl.	57.74	(2.05)	549,784	US Prime Rate	4.25	0.00
S&P 500	2,601.42	(0.04)	21.93	ICE Brent Oil	USD/bbl	63.60	(0.41)	235,178	US Discount Window	1.75	0.00
NASDAQ	6,878.52	(0.15)	43.02	NYMEX Natural Gas	USD/MMBtu	2.95	4.91	115,489	US Treasury (1 Yr)	1.1287	0.24
MSCI US	2,478.36	(0.05)	22.35	China Qinhuangdao Port Thermal Coal ²	USD/Metric Tonne	61.80	N/A	N/A	US Treasury (5Yr)	2.0545	(0.91)
Europe				Basic Metals				US Treasury (10 Yr)	2.3277	(1.41)	
FTSE 100	7,383.90	(0.35)	21.99	LME Aluminum Cash	USD/MT	2,119.75	0.12	7,609	Japan 10-Yr Gov. Bond	0.0380	0.90
DAX	13,000.20	(0.46)	19.07	LME Aluminum 3 -mth. Rolling Fwd.	USD/MT	2,135.00	0.14	26,174	China 10-Yr Gov. Bond	3.9980	2.50
CAC40	5,360.09	(0.56)	18.42	CMX Copper Active	USD/lb.	6,921.50	(0.92)	18,289	ECB Rate (Refinancing)	0.00	0.00
IBEX 35	10,063.10	0.10	15.15	LME Copper 3- mth Rolling Fwd.	USD/MT	6,942.00	(0.86)	27,599	1-Month LIBOR	1.3376	5.04
FTSE MIB	22,176.70	(1.07)	479.7	Precious Metals				3 Month LIBOR	1.4676	2.70	
Stoxx 600	384.87	(0.46)	20.55	CMX Gold	USD/T. oz	1,298.40	0.51	86,018	O/N SHIBOR	2.7990	0.20
MSCI UK	2,138.42	(0.36)	22.50	CMX Silver	USD/T. oz	17.10	0.04	34,815	1-mth SHIBOR	4.0367	(0.12)
MSCI France	153.83	(0.49)	18.53	NYMEX Platinum	USD/T. oz	950.50	0.55	19,371	3-mth HIBOR	1.1332	13.82
MSCI Germany	160.44	(0.46)	18.92	Agricultural Products				Corporate Bonds (Moody's)			
MSCI Italy	60.98	(1.05)	N/A	CBOT Corn	USD/bu	350.50	(1.27)	205,280	Aaa	3.53	(8.00)
Asia				CBOT Wheat	USD/bu	431.00	(0.86)	69,514	Baa	4.24	(4.00)
NIKKEI 225	22,486.24	(0.29)	19.29	NYB-ICE Sugar	USD/lb.	15.39	(0.39)	56,203	Note:		
S&P/ASX 200	5,984.25	0.03	17.72	CBOT Soybeans	USD/bu.	992.75	(0.05)	93,605	1. Data sources: Bloomberg, National Bureau of Statistics of China, ABCIS (updated on date of report)		
HSI	29,484.66	(1.28)	13.79	2. The price is Coal 5500 kcal/kg FOB Spot Price							
HSCEI	11,642.92	(2.23)	9.25								
CSI300	4,045.26	(1.44)	16.70								
SSE Composite	3,328.47	(0.76)	16.79								
SZSE Composite	1,911.83	(0.57)	32.02								
MSCI China	90.16	(1.39)	17.41								
MSCI Hong Kong	15,755.82	(0.39)	13.13								
MSCI Japan	1,053.42	(0.22)	15.83								

Currency

	Euro/USD	GBP/USD	AUD/USD	USD/JPY	USD/CHF	USD/CNY	USD/HKD	USD/CNY NDF 12-mth Spot pr.
Spot Rate	1.1908	1.3331	0.7614	111.19	0.9813	6.6030	7.8031	6.7610
Chg. WTD (%)	(0.21)	(0.05)	(0.04)	0.31	(0.18)	(0.02)	0.06	(0.26)



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

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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