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China PMI shows reliance on domestic demand

- NBS's mfg PMI in Aug hit 50.4, the highest since Nov 2014
- Business of large-sized enterprises were expanding, but that of small-/mid-sized enterprises remained sluggish
- New orders index has stayed above 50 for six consecutive months but new export orders index has remained below 50 for three months
- Manufacturers are tightening control in working capital and human resources to enhance production efficiency
- Standard deviation of Caixin's mfg PMI almost doubled that of NBS, causing discrepancy in short-term economic outlook

Mfg PMI rebounded to 50.4 in Aug, the highest since Nov 2014.

PMI of large-sized enterprises has stayed at above 50 for six consecutive months, but PMI of medium-sized and small-sized enterprises have stayed below 50 for three and 25 months, respectively. Therefore, we conclude that the rebound in headline mfg PMI was mainly driven by increased economic activities of large-sized enterprises (Refer to Exhibit 1).

The manufacturing industry still relies heavily on domestic demand.

New orders index edged up to 51.3 in Aug, the highest since Apr. New orders index in mfg industry has been above 50 for six consecutive months. New export orders index inched up to 49.7 in Aug, staying below 50 for three consecutive months, indicating most of the new orders were originated from the domestic market. Besides, we believe most of new orders can be completed in short term, as backlogs of orders index has been below 50 since Mar 2012. Subsequently, employers were highly cautious on expanding their workforce, as reflected by the employment index that has stayed below 50 since May 2012. Large-sized enterprises were the ones who obtained most of the new orders and PMI of large-sized enterprises suggested their businesses were expanding. Investors in small-/medium-sized manufacturing companies, however, should remain guarded.

Manufacturers focus on working capital and human resources management to raise production efficiency.

Output index increased to 52.6 in Aug, the highest since July 2015. However, inventory of major inputs index, inventory of finished goods index, and employment index have been below 50 since Apr 2013. The continued expansion of production output has not led to an equivalent increase in inventory of input raw materials, finished goods, and workforce. It is likely that manufacturers are tightening their control on working capital and human resources in order to improve efficiency.

Weak domestic and overseas new orders flows in non-manufacturing industry do not bode well for the employment market.

Non-manufacturing PMI eased to 52.7 in Aug, the lowest since Feb 2011; new orders index and foreign new orders index have been below 50 for two months and eight months, while employment index has been below 50 for 19 months. New order flow in the non-manufacturing industry showed extended weakness, discouraging employers to expand their workforce.



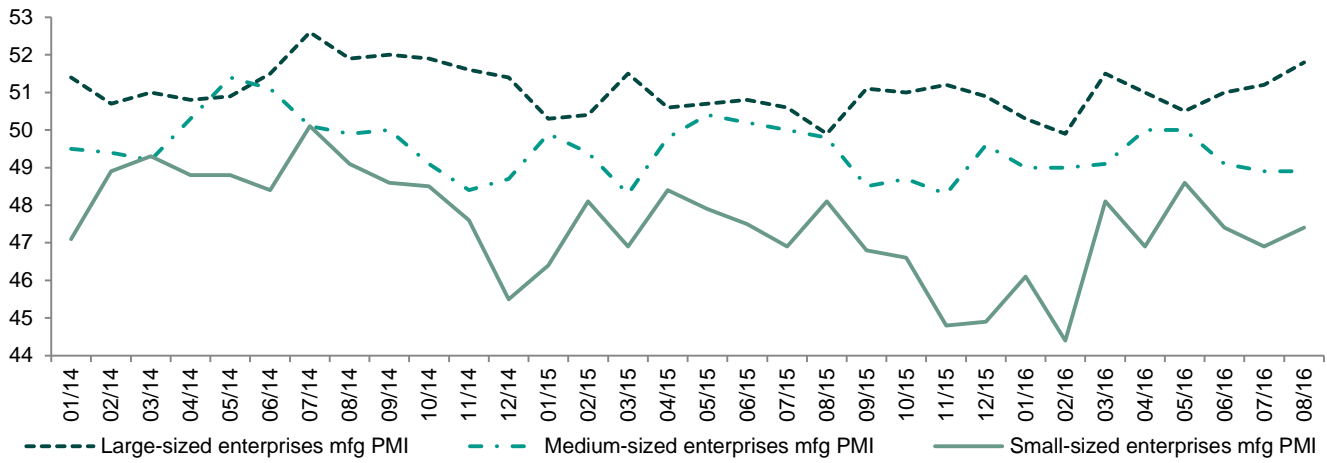
Construction industry is in a better shape than the services industry. Within the non-manufacturing industry, the construction industry is in a better shape than the services industry. Within the construction index, the new order index and employment index have exceeded 50 for six and three consecutive months, indicating employers in the construction industry are willing to expand their workforce to cope with the rising new orders. In contrast, the new orders index in services industry has been below 50 for five consecutive months and the employment index has been below 50 for more than two years.

NBS's PMI and Caixin's PMI in Aug indicated diverging growth momentum within the manufacturing and non-manufacturing industries. NBS's mfg PMI in Aug indicated business activities in manufacturing industry were expanding in an accelerated pace; however, Caixin's mfg PMI for the same month reflected business activities in manufacturing industry were expanding at a decelerated pace. Meanwhile, NBS's non-mfg PMI in Aug pointed that the business activities in non-manufacturing industry were expanding in a reduced pace, while Caixin's non-mfg PMI showed business activities in non-manufacturing industry were expanding more rapidly than before. The diverging growth momentum demonstrated by the two sets of PMI by Caixin and NBS raises concerns over the creditability of the survey results. We, however, perceive this divergence as reasonable due to the differences in sample size and standard deviation (SD) between the institutes' survey data.

Standard deviation of Caixin's mfg PMI almost doubled that of NBS. Between Jan 2014 and Aug 2016, the SDs of Caixin's and NBS's mfg PMI survey data were 1.08 and 0.54- a difference mainly arises from the varying sample size (i.e. the number of survey respondents) between the two surveys, which was 500 for Caixin's and 3000 for NBS's. For the non-mfg PMI, SDs of Caixin's and NBS's survey data were 1.07 and 0.65 for the same period. The sample size for Caixin's mfg PMI survey was 400 and 4000 for NBS's. Traders and speculators in capital and currency markets may prefer to use Caixin-Markit PMI as a higher standard deviation of the data series will result in greater market volatility, which in turn will increase trading opportunities. Governments or economists may prefer to use NBS PMI as its larger sample size and lower standard deviation should capture more accurately of the overall economic situation and smoothen out fluctuations of the economic data. (Exhibits 4 & 5).

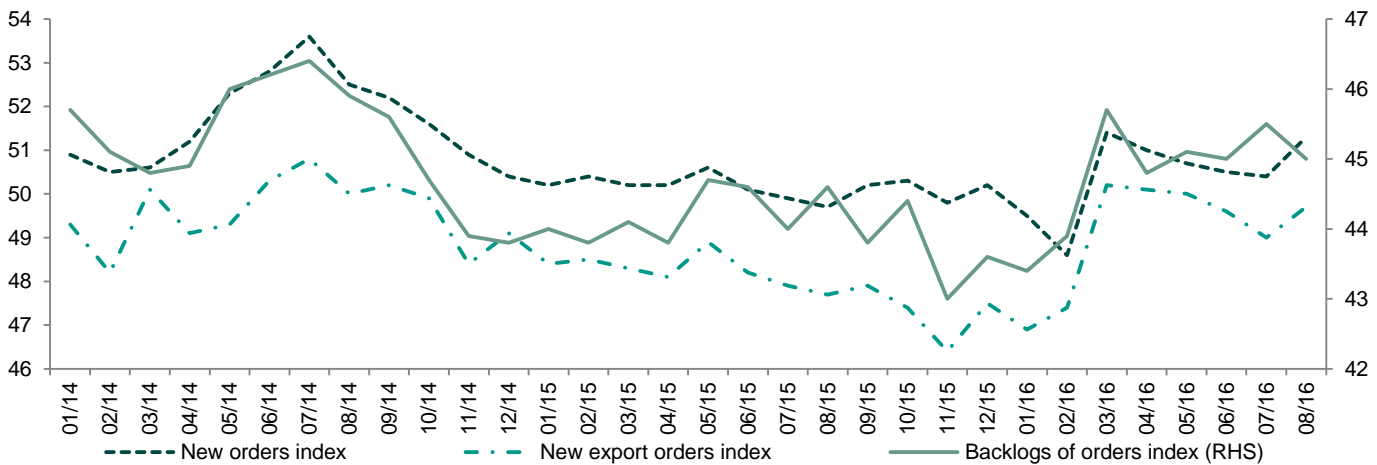


Exhibit 1: Manufacturing PMIs by business scale of enterprises



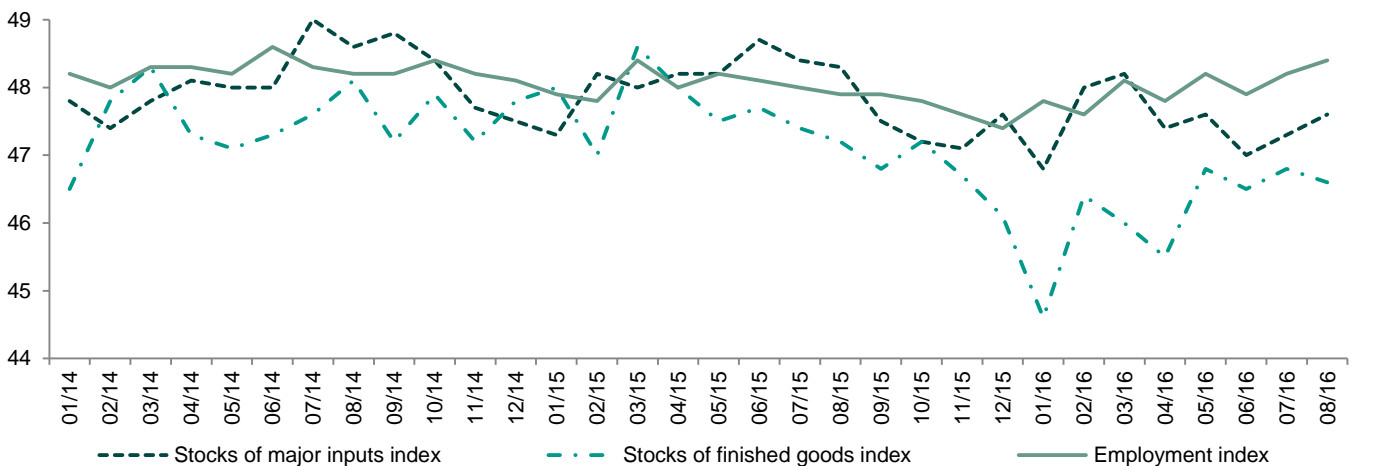
Source(s): NBS, ABCI Securities

Exhibit 2: New orders in manufacturing industry were mainly originated from the domestic market with low backlogs of orders



Source(s): NBS, ABCI Securities

Exhibit 3: Manufacturers are reducing working capital requirement (inputs and finished goods) and workforce (indices below 50 indicates contraction)



Source(s): NBS, ABCI Securities

**Exhibit 4: Difference in sample size between Caixin's and NBS's mfg PMI survey data may cause discrepancy in survey results**

	Caixin-Markit China Mfg PMI 500	NBS China Mfg PMI 3000
Sample size		
Survey results:		
Aug data	50.0 (-0.6)	50.4 (+0.5)
Jul data	50.6 (+2.0)	49.9 (-0.1)
Jun data	48.6 (-0.6)	50.0 (-0.1)
Standard deviation from Jan 2014 to Aug 2016 (i.e. 32 mths)	1.08	0.54
Standard deviation from Sep 2015 to Aug 2016 (i.e. 12 mths)	0.95	0.38
<u>Volatility</u>	<u>Higher</u>	<u>Lower</u>

Source(s): Caixin-Markit, NBS, ABCI Securities

Exhibit 5: Difference in sample size between Caixin's and NBS's PMI survey data may cause discrepancy in survey results

	Caixin-Markit China Non-mfg PMI 400	NBS China Non-mfg PMI 4000
Sample size		
Survey results:		
Aug data	52.1 (+0.4)	52.7 (-1.2)
Jul data	51.7 (-1.0)	53.9 (+0.2)
Jun data	52.7 (+1.5)	53.7 (+0.6)
Standard deviation from Jan 2014 to Aug 2016 (i.e. 32 mths)	1.07	0.65
Standard deviation from Sep 2015 to Aug 2016 (i.e. 12 mths)	0.76	0.49
<u>Volatility</u>	<u>Higher</u>	<u>Lower</u>

Source(s): Caixin-Markit, NBS, ABCI Securities



China Economic Indicators

	2015							2016						
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul
Real GDP (YoY %)	7.0	---	---	6.9	---	---	6.8	---	---	6.7	---	---	6.7	---
Export Growth (YoY %)	2.8	(8.3)	(5.5)	(3.7)	(6.9)	(6.8)	(1.4)	(11.2)	(25.4)	11.5	(1.8)	(4.1)	(4.8)	(4.4)
Import Growth (YoY %)	(6.1)	(8.1)	(13.8)	(20.4)	(18.8)	(8.7)	(7.6)	(18.8)	(13.8)	(7.6)	(10.9)	(0.4)	(8.4)	(12.5)
Trade Balance (USD/bn)	46.6	43.0	60.2	60.3	61.6	54.1	60.9	63.3	32.6	29.9	45.56	49.98	48.11	52.31
Retail Sales Growth (YoY %)	10.6	10.5	10.8	10.9	11.0	11.2	11.1	10.2		10.5	10.1	10.0	10.6	10.2
Industrial Production (YoY %)	6.8	6.0	6.1	5.7	5.6	6.2	5.9	5.4		6.8	6.0	6.0	6.2	6.0
PMI - Manufacturing (%)	50.2	50.0	49.7	49.8	49.8	49.6	49.7	49.4	49.0	50.2	50.1	50.1	50.0	49.9
PMI - Non-manufacturing (%)	53.8	53.9	53.4	53.4	53.1	53.6	54.4	53.5	52.7	53.8	53.5	53.1	53.7	53.9
FAI (YTD) (YoY %)	11.4	11.2	10.9	10.3	10.2	10.2	10.0	10.2		10.7	10.5	9.6	9.0	8.1
CPI (YoY %)	1.4	1.6	2.0	1.6	1.3	1.5	1.6	1.8	2.3	2.3	2.3	2.0	1.9	1.8
PPI (YoY %)	(4.8)	(5.4)	(5.9)	(5.9)	(5.9)	(5.9)	(5.9)	(5.3)	(4.9)	(4.3)	(3.4)	(2.8)	(2.6)	(1.7)
M2 (YoY %)	11.8	13.3	13.3	13.1	13.5	13.7	13.3	14.0	13.3	13.4	12.8	11.8	11.8	10.2
New Lending (RMB/bn)	1,280.6	1,480	809.6	1,050	513.6	708.9	597.8	2,510	726.6	1,370	555.6	985.5	1,380	463.6
Aggregate Financing (RMB bn)	1,833	742	1,082	1,300	476.7	1,020	1,815.1	3,425.3	824.5	2,404.0	751.0	659.9	1,629.3	487.9

World Economic/Financial Indicators

Equity Indices				Global Commodities					Bond Yields & Key Rates		
	Closing price	Chg. WTD (%)	P/E	Unit	Price	Chg. WTD (%)	Vol (5-Day avg.)		Yield (%)	Chg. WTD (Bps)	
U.S.				Energy					US Fed Fund Rate		
DJIA	18,491.96	0.00	17.81	NYMEX WTI	USD/bbl.	46.04	3.60	493,424	0.50	0.00	
S&P 500	2,179.98	0.00	20.45	ICE Brent Oil	USD/bbl	48.75	4.10	156,037	3.50	0.00	
NASDAQ	5,249.90	0.00	40.96	NYMEX Natural Gas	USD/MMBtu	2.77	(0.79)	104,537	1.00	0.00	
MSCI US	2,078.05	0.00	21.16	China Qinhuangdao Port Thermal Coal ²	CNY/Metric Tonne	488.00	2.31	N/A	0.2434	0.00	
Europe				Basic Metals					US Treasury (1 Yr)		
FTSE 100	6,885.29	(0.14)	57.29	LME Aluminum Cash	USD/MT	1,575.75	0.00	18,739	1.1914	0.00	
DAX	10,709.64	0.24	24.33	LME Aluminum 3 -mth. Rolling Fwd.	USD/MT	1,594.00	0.00	42,525	1.6024	0.00	
CAC40	4,559.56	0.38	23.47	CMX Copper Active	USD/lb.	4,617.25	0.00	17,286	0.2434	0.00	
IBEX 35	8,950.70	0.47	22.23	LME Copper 3- mth Rolling Fwd.	USD/MT	4,627.00	0.00	44,000	1.1914	0.00	
FTSE MIB	17,279.13	0.55	40.63	Precious Metals					US Treasury (10 Yr)		
Stoxx 600	351.14	0.20	27.32	CMX Gold	USD/T. oz	1,331.30	0.35	179,071	1.6024	0.00	
MSCI UK	2,008.30	0.00	61.03	CMX Silver	USD/T. oz	19.50	0.67	52,865	0.2434	0.00	
MSCI France	128.75	0.00	21.29	NYMEX Platinum	USD/T. oz	1,072.70	0.99	11,496	1.1914	0.00	
MSCI Germany	136.50	0.00	24.46	Agricultural Products					Japan 10-Yr Gov. Bond		
MSCI Italy	49.05	0.00	40.88	CBOT Corn	USD/bu	328.50	0.00	208,271	(0.03)	0.00	
Asia				CBOT Wheat	USD/bu	399.25	0.00	73,624	2.7980	1.10	
NIKKEI 225	17,037.63	0.66	21.22	NYB-ICE Sugar	USD/lb.	20.18	0.00	64,060	0.00	0.00	
S&P/ASX 200	5,429.58	1.06	24.51	CBOT Soybeans	USD/bu.	952.50	0.00	89,610	0.5257	0.13	
HSI	23,649.55	1.65	12.87						0.8351	0.17	
HSCEI	9,830.57	1.48	8.31						2.0700	0.40	
CSI300	3,319.68	0.17	15.31						1-mth SHIBOR	2.6860	(0.40)
SSE Composite	3,072.10	0.15	17.82						3-mth HIBOR	0.5714	0.00
SZSE Component	10,695.45	0.52	32.37						Corporate Bonds (Moody's)		
MSCI China	62.46	0.00	13.54						Aaa	3.24	(6.00)
MSCI Hong Kong	12,958.11	0.00	14.69						Baa	4.19	(6.00)
MSCI Japan	813.16	0.00	17.30								

Note:

- Data sources: Bloomberg, National Bureau of Statistics of China, ABCIS (updated on date of report)
- The price is Coal 5500 kcal/kg FOB Spot Price

Currency

	Euro/USD	GBP/USD	AUD/USD	USD/JPY	USD/CHF	USD/CNY	USD/HKD	USD/CNY NDF 12-mth Spot pr.
Spot Rate	1.1167	1.3331	0.7595	103.25	0.9784	6.6770	7.7553	6.8405
Chg. WTD (%)	0.10	0.28	0.29	0.65	0.26	0.05	0.00	0.05



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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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